Supreme Court, U.S.
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IN THE

Supreme Court of the United States

KAWASAKI MOTORS CORP., U.S.A.,

Petitioner,

v.

BOB SCHULTZ MOTORS, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (the "FAA"), the District Court ordered arbitration of the parties' dispute, rejecting challenges to the enforceability of the parties' arbitration agreement. After ruling on the merits of the dispute, the Arbitrator concluded that the District Court had erred in enforcing the arbitration agreement. Based upon that conclusion, the Arbitrator refused to enforce the remaining executory term of the arbitration agreement, which provided that the losing party pays the winning party's arbitration expenses and costs. The District Court denied a request to vacate or modify the award under FAA Sections 10 or 11, and the Eighth Circuit affirmed. The questions presented are:

1. Whether the enforceability of the terms of an arbitration agreement is an issue of arbitrability for the courts to decide under the FAA.

2. Whether a court's pre-arbitration ruling on arbitrability under Section 4 of the FAA constrains the scope of an arbitrator's powers within the meaning of Section 10(a)(4) or the scope of the matters submitted to the arbitrator within the meaning of Section 11(b) for purposes of post-arbitration judicial review.

PETITIONER KAWASAKI MOTORS CORP., U.S.A'S STATEMENT OF PARTIES AND CORPORATE DISCLOSURE STATEMENT

The parties are listed in the caption of this case. Petitioner Kawasaki Motors Corp , U.S.A. is a wholly-owned subsidiary of Kawasaki Heavy Industries, Ltd., which is a publicly-held Japanese corporation in which no shareholder owns more than 10% of the shares.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Kawasaki Motors Corp., U.S.A. ("Kawasaki") hereby respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case, which was entered on July 1, 2003.

OPINIONS BELOW

The District Court's Order (The Honorable Charles A. Shaw), dated March 26, 2002, denying Kawasaki's motion to vacate or modify the arbitrator's decision, is unpublished. It is reprinted in the Appendix at App. A-51 to A-64. The Court of Appeals' opinion (App. A-1 to A-12) is reported at 334 F.3d 721 (8th Cir. 2003).

JURISDICTIONAL STATEMENT

The Court of Appeals entered its judgment on July 1, 2003. It denied Kawasaki's timely petition for rehearing *en banc* on August 13, 2003. Kawasaki invokes this Court's jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, are reproduced at App. A-65 through A-69.

STATEMENT OF THE CASE

A. Summary

Bob Schultz Motors, Inc. ("Schultz Motors"), a Kawasaki franchisee, sued Kawasaki under numerous legal theories and sought a declaratory judgment that an arbitration agreement between the parties (the "Arbitration Agreement") was unenforceable. The District Court rejected Schultz Motors' contention, ruling that the Arbitration Agreement was enforceable, and directed the parties to arbitration. Neither the District Court's orders nor the pleading pending at the time of arbitration submitted the enforceability of the Arbitration Agreement's terms to arbitration.

After ruling in favor of Kawasaki on the merits of the dispute, the Arbitrator proceeded to consider Kawasaki's request for attorney's fees pursuant to a fee shifting provision in the Arbitration Agreement. The Arbitrator – disagreeing with the district court's prior conclusion – concluded that the Arbitration Agreement was unenforceable. Since the arbitration had already occurred, however, the Arbitrator simply refused to enforce the only remaining executory term of the Arbitration Agreement, which provided that the losing party pays the winning party's expenses and fees.

Kawasaki then challenged the arbitrator's ruling. Both the District Court and the Court of Appeals ruled that such enforceability issues were for the Arbitrator, rejecting Kawasaki's challenge that the Arbitrator exceeded his authority or ruled upon a matter not submitted to him.

B. The Arbitration Agreement

The Arbitration Agreement between Schultz Motors and Kawasaki is contained in the parties' Dealer Sales and Service Agreement. It reads as follows:

> 32. Dispute Resolution
>
> All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR, relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claims or disputes, except those expressly excluded above. Judgment upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against the DISTRIBUTOR, or in any court which has jurisdiction over DEALER, if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing

party all costs and expenses of the arbitration, including without limitation, attorney's fees.

C. Schultz Motors sued Kawasaki

On February 23, 1993, Schultz Motors filed a five count state court petition against Kawasaki, seeking relief for Kawasaki's alleged wrongful failure to permit Schultz Motors to purchase another Kawasaki dealership. Schultz Motors alleged breach of contract, tortious interference with contractual relationship, breach of third party beneficiary contract, and violations of the Missouri Motor Vehicle Franchise Practices Act. Schultz Motors' petition also included a separate count for declaratory relief, challenging the enforceability of the Arbitration Agreement.

Kawasaki removed the action to the United States District Court for the Eastern District of Missouri and filed a motion to dismiss each count of Schultz Motors' petition. Among other things, Kawasaki asserted that the Arbitration Agreement was enforceable and sought to have any claims that were not dismissed referred to arbitration.

D. The District Court held that the Arbitration Agreement was enforceable and referred the dispute to arbitration.

On March 30, 1994, the District Court ruled on Kawasaki's Motion to Dismiss, dismissing Schultz Motors' third-party beneficiary and tortious interference claims for failure to state a claim. App. A-24 to A-25. The District Court also ruled for Kawasaki on Schultz Motors' declaratory judgment claim, holding that the Arbitration Agreement was enforceable. The District Court directed the parties to arbitrate Schultz Motors' remaining two claims (breach of contract and a statutory count), finding that those claims were within the scope of the Arbitration Agreement. App. A-24 to A-25.

In the course of ruling on the declaratory judgment count, the district court addressed each of Schultz Motors' claims that the Arbitration Agreement was unenforceable. The district court concluded that Schultz Motors had not established that the arbitration agreement 1) was unconscionable or inherently unfair, 2) constituted a contract of adhesion, 3) lacked mutuality of obligation, or 4) violated the Missouri Motor Vehicle Franchise Practices Act.[1] App. A-18 to A-21. The District Court therefore concluded that the Arbitration Agreement was enforceable and compelled arbitration. App. A-24 to A-25.

E. Schultz Motors filed a Demand for Arbitration

After the District Court's ruling, Schultz Motors submitted a Demand for Arbitration, dated September 27, 1994, on the American Arbitration Association's standard commercial arbitration form. In its demand, Schultz Motors conceded that the District Court had not submitted to arbitration most of the enforceability arguments raised in its petition. "[T]he District Court issued an order . . . determining, *inter alia*, that . . . only one of the of the numerous arguments presented in Count V of the Petition in support of Bob Schultz' claim that the applicable Arbitration clause be declared unenforceable should be decided in arbitration, namely . . . duress."[2]

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[1] Schultz Motors also had alleged duress as a ground for avoiding the Arbitration Agreement. The District Court found that this allegation went to the formation of the entire Dealer Sales and Service Agreement and therefore, under *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1966), should be decided by the arbitrator. This issue dropped out of the litigation, however, when Schultz Motors abandoned the issue in correspondence with the arbitrator before the arbitration hearing.

[2] As to the duress argument, see footnote 1, above.

Nevertheless, Schultz Motors requested that the arbitrator rule on its enforceability arguments because it thought that such a request might be necessary to preserve its disagreement with the District Court for appeal. "Bob Schultz submits these latter grounds [concerning enforceability] for consideration by the arbitrators [sic] herein, despite the District Court's prior determinations as to them, because Bob Schultz believes that the District Court determinations were erroneous and that submission of them to the arbitrators [sic] may be necessary to preserve said grounds for appeal." The arbitration did not proceed upon this Demand for Arbitration, however, as Schultz Motors filed two more statements of its claim.

F. Schultz Motors filed an Amended Demand for Arbitration, which the District Court limited in scope

Schultz Motors submitted an Amended Demand for Arbitration dated February 3, 1995. Unlike the original Demand, this Amended Demand stated various counts for relief in a form similar to a complaint. The Amended Demand also expanded the number of counts to eight, including a Count VI seeking a declaration that the Arbitration Agreement was unenforceable.

The parties returned to the District Court to resolve their dispute over whether the new counts in the Amended Demand were arbitrable. In its motion on the issue, Schultz Motors' motion suggested that, even if some of the counts in the Amended Demand were identical to counts dismissed by the District Court, the arbitrator should be free to rule upon them.

In ruling on Schultz Motors' motion, the District Court disagreed with the argument that the arbitrator should be free to rule upon dismissed claims. "This Court may reconsider the prior order, . . . but the Arbitrator must adhere to the Court's rulings on legal issues." The District Court then ordered that 1) "the Arbitrator shall not consider Counts II,

III, and IV of the amended demand;" 2) "the Arbitrator shall consider Counts VII and VIII of the amended demand;" and 3) "the Arbitrator shall not consider any new claims which plaintiff may assert prior to this Court's determination that the claims are arbitrable." App. A-29.[3]

G. Schultz Motors Filed a Second Amended Complaint, which the District Court dismissed in part and which did not include a claim that the Arbitration Agreement was unenforceable

A few months after the District Court's ruling concerning its Amended Demand, Schultz Motors sought leave to file a Second Amended Complaint. This Second Amended Complaint expanded the number of counts to nine, but it contained no count or allegations concerning the enforceability of the Arbitration Agreement or any of its terms.

The District Court, entered an order on January 30, 1996, granting Schultz Motors leave to file the Second Amended Complaint. The order also specified which counts would be dismissed and which would be arbitrated: 1) "Counts I, II, III, IV and V of the Second Amended Complaint are hereby dismissed;" 2) "Counts VI, VII, VIII and IX of the Second Amended Complaint are referred to the previous arbitrator . . . ;" and 3) "The Court's previous ruling on the handling of this matter remains in effect." App. A-31.

As a result of this order, the District Court submitted to arbitration two counts alleging breach of contract and two counts alleging violation of the Missouri Motor Vehicle

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[3] Schultz Motors' Amended Demand included a "Count VI" that challenged the enforceability of the Arbitration Agreement. But the District Court did not refer this count to arbitration.

Franchise Practices Act. The order did not submit any enforceability issues to arbitration.

H. Kawasaki prevailed in the arbitration.

The arbitration proceeded in Los Angeles, California in March 2000. After a three-week hearing, the Arbitrator issued his liability ruling (the "First Award") and held, inter alia, that Kawasaki was not liable to Schultz Motors for any damages. The Arbitrator further held that "[Kawasaki] is the prevailing party in this proceeding and in accordance with ¶ 32 of the Agreements is entitled to recover from claimant all costs and expenses of the arbitration, including without limitation, attorney's fees." The Arbitrator then permitted Schultz Motors to conduct discovery regarding the attorney's fees and expenses and later conducted a hearing with respect to the amount of Kawasaki's costs and attorney's fees.

I. The Arbitrator issued a second opinion finding that the fee-shifting provision of the Arbitration Agreement was unenforceable.

At the hearing on Kawasaki's attorney's fees claim, Kawasaki established that its attorney's fees and litigation costs totaled $1,772,815.23. Schultz Motors renewed the enforceability arguments that the District Court had previously rejected, and which had not been submitted to arbitration, but this time directed them solely to the fee-shifting term of the Arbitration Agreement. Kawasaki contended that this issue had been resolved by the District Court.

The Arbitrator issued his Final Award of Arbitration (the "Second Award"), including his Statement of Reasons in Support of Ruling on Costs and Expenses, on January 31, 2001. In this Award, he ruled that the Arbitration Agreement should not have been enforced.

> The Arbitrator believes that ¶ 32 is unconscionable and should not have been

> enforced. However, the Court decided that the case should be referred to arbitration and declined to change the venue from Los Angeles to St. Louis. It's too late to alter that result at this time. However, the Court did not rule upon that part of ¶ 32 that requires the nonprevailing party to pay all of the costs and expenses of the prevailing party. The issue of the enforceability of that clause is properly before the Arbitrator at this time.

App. A-48. In reaching this conclusion, the Arbitrator made a number of findings that directly contradicted the District Court's two previous Orders. These contradictory rulings are shown on the following chart:

Court: "The court rejects Schultz Motors' argument that the franchise agreements are contracts of adhesion." (App. A-18).	***Arbitrator:*** "The arbitration clause of the franchise agreement is clearly a contract of adhesion . . . ." (App. A-44).
Court: "Nor does the Court agree that the arbitration clause lacks mutuality of obligation." (App. A-19).	***Arbitrator:*** "First, the Agreement lacks mutuality . . . ." (App. A-46).
Court: "Schultz Motors has failed to show that Kawasaki's arbitration clause is unconscionable or inherently unfair." (App. A-19).	***Arbitrator:*** "The Arbitrator also finds that the arbitration agreements were unconscionable at the time they were made . . . ." (App. A-44).

Court: "Schultz Motors next argues that the arbitration clause violates Missouri public policy as expressed in the Missouri Motor Vehicles Franchise Practices Act . . . . The Court disagrees." (App. A-19).	***Arbitrator:*** "Kawasaki's institutional policy of imposing its contractual terms on dealers with the threat of losing the dealership is just such an unlawful practice [under the Missouri Motor Vehicles Franchise Protection Act]." (App. A-44).
Court: "Counts VII and VIII of the amended demand are proper for arbitration . . . . The arbitrator should refuse to consider any additional claims until this Court has determined their arbitrability." (App. A-28). "[T]he Arbitrator must adhere to the Court's rulings on legal issues." (App. A-28).	***Arbitrator:*** "The Arbitrator . . . finds that . . . the Arbitrator is free to decide whether the costs and expenses provision of the arbitration clause is unconscionable . . . . It is the opinion of the Arbitrator that whether the costs and expenses provision of ¶ 32 is unconscionable or not is an open issue to be decided by the Arbitrator . . . (App. A-39).

J. The District Court enforced the Arbitrator's decision.

On February 16, 2001, the parties filed a joint motion with the District Court to reopen the case. Kawasaki filed its motion to confirm the Arbitrator's First Award with respect to liability and to vacate the Arbitrator's Second Award with respect to attorney's fees. Schultz Motors opposed Kawasaki's motion and moved in the alternative that the District Court vacate all of the Arbitrator's awards, including

the liability finding for Kawasaki, if the District Court concluded that the Arbitrator exceeded his powers in ruling on the enforceability of the fee-shifting provision.

On March 26, 2002, the district court issued a Memorandum and Order confirming both of the Arbitrator's awards in all respects. App. A-51 to A-64. The district court stated that "the arbitrator correctly interpreted this Court's order of March 30, 1994 as addressing only the issue of arbitrability, *i.e.*, whether the arbitration provision between the parties should be enforced to require their dispute to be arbitrated." App. A-60. The district court then declined to review the Arbitrator's decision, finding that the Arbitrator had the authority to "make mistakes" in ruling on legal questions such as enforceability.

> Given the arbitrator's power to interpret the Franchise Agreement, to find facts, to interpret and apply the law, and to make mistakes in so doing, the Court finds the arbitrator neither exceeded his powers nor awarded on a matter not submitted to him . . . ."

App. A-61. On this basis, the District Court confirmed the Arbitrator's Second Award and denied Kawasaki's motion to vacate the award with respect to attorney's fees. App. A-61 to A-62.

K. The Court of Appeals affirmed the District Court decision.

On July 1, 2003, the United States Court of Appeals for the Eighth Circuit affirmed the District Court's decision, holding that the Arbitrator acted within the scope of his authority by refusing to enforce the fee-shifting provision of the Arbitration Agreement. 334 F.3d 721; App. A-1 to A-12. Relying on *Larry's United Super, Inc. v. Werries,* 253 F.3d 1083 (8th Cir. 2001), the Eighth Circuit held that the issue of

the validity of the Arbitration Agreement's fee-shifting provision was an issue for the Arbitrator to decide with no review by the courts. 334 F.3d at 727 n.3; App. A-10. The Eighth Circuit denied Kawasaki's motion for rehearing *en banc* on August 13, 2003. App. A-64.

REASONS FOR GRANTING THE PETITION

1. Overview

Under the Federal Arbitration Act, courts decide gateway issues of arbitrability, unless the parties have clearly agreed to submit these issues to arbitration. *First Options v. Kaplan*, 514 U.S. 938, 943-44 (1995). There typically are two arbitrability issues: 1) whether the parties are bound by a given arbitration clause, and 2) whether the parties' dispute falls within the scope of the agreement to arbitrate. *See, e.g., Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002).

The courts of appeals disagree about the scope of the first issue, enforceability. In the First, Seventh, Eighth, and Eleventh Circuits, the courts divide the enforceability analysis. In those circuits, the court decides whether the partis are obligated to arbitrate. But, the arbitrator decides the enforceability of arbitration terms such as remedial limitations or fee-shifting provisions. Thus, these courts view the enforceability of arbitration terms as a separate issue from the enforceability of arbitration itself. (There is some inconsistency among these courts. For example, they disagree about whether courts should later substantively review the arbitrator's decision regarding the enforceability of arbitration terms.)

In the Third, Fourth, Fifth, Sixth, Ninth, and Tenth Circuits, the enforceability of the terms of an arbitration agreement is an issue for the courts. In these circuits, courts determine whether the parties' arbitration terms are enforceable and, if they are not, whether the unenforceable terms may be severed from the remainder of the arbitration agreement so arbitration can proceed. This majority position is consistent with the FAA, which directs the court to consider challenges to the "making" of an arbitration

agreement, and then to order "the parties to proceed with the arbitration in accordance with the terms thereof" (9 U.S.C. § 4) – a command that logically requires the courts to determine which "terms" are enforceable.

The majority position is also consistent with this Court's decisions on comparable issues. *See Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000) (considering whether an arbitration agreement's silence on the allocation of arbitration costs rendered it unenforceable); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30-33 (1991) (considering challenges to arbitration based upon limits on discovery, lack of written opinions, limits on equitable relief, and lack of class actions); *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989) (considering whether state court rule regarding staying arbitration, incorporated into the parties' arbitration agreement by a choice of law provision, was unenforceable because of a conflict with FAA); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.21 (1985) ("[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.").

In this case, Kawasaki happened to be seeking enforcement of its FAA rights in the Eighth Circuit. It was therefore subject to 1) overlapping and inconsistent rulings on the enforceability of arbitration terms by the District Court and the Arbitrator, 2) new claims by its opponent concerning the enforceability of arbitration terms after the District Court's section 4 proceeding and after the Arbitrator's award on the merits of the arbitration, and 3) no substantive judicial review of these matters. This would not have occurred in many other circuits. This Court should resolve the disagreements among the courts of appeals and

the conceptual confusion evident in the courts of appeals' opinions about what issues a court should decide, and when, in order to prevent such disparate applications of the FAA.

2. The courts of appeals disagree about whether the courts or arbitrators should decide the enforceability of arbitration terms.

As discussed below, the courts of appeals generally split four circuits to six on the question of who decides the enforceability of arbitration terms. *See, e.g., Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314, 316 (5th Cir. 2002) ("The circuit courts are split on whether the enforceability of an arbitration clause should be adjudicated before arbitration when a party contends that public policy prevents the clause's waiver of certain remedies."). There also are some inconsistencies and analytical disagreements within the minority group, further illustrating the need for a coherent resolution of this issue by this Court.

a. Six circuits allocate enforceability determinations to the courts (Third, Fourth, Fifth, Sixth, Ninth, and Tenth)

Sitting *en banc*, the Sixth Circuit recently addressed the enforceability of the terms of an arbitration agreement. *See Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003). *Morrison* involved two employees whose employment agreements contained arbitration provisions that provided, among other things, for splitting arbitration costs among the parties, and one employee's agreement imposed limits on the remedies he could obtain through arbitration. The employees contended that these provisions had the effect of denying them a forum for the vindication of their statutory rights.

The *Morrison* Court analyzed how and when such challenges should be made, explicitly rejecting post-

arbitration judicial review and implicitly rejecting arbitration as the correct venue. 317 F.3d at 657-65. The court then considered the merits of the challenges to the arbitration provisions. It found that some of the provisions in each arbitration agreement were unenforceable, *id.* at 665-74, 675-77, but also determined that these provisions were severable from the remainder of the arbitration agreements, thus making arbitration appropriate. *Id.* at 674-75, 678.

Most of the courts of appeals follow a similar pattern of analysis in evaluating challenges to the enforceability of arbitration terms. *See Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003)[4]; *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Hadnot v. Bay, Ltd.*, 344 F.3d 474 (5th Cir. 2003); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); *Shankle v. B-G Maintenance Management*, 163 F.3d 1230 (10th Cir. 1999).

On numerous occasions, these circuits have explicitly concluded that courts, not arbitrators, should decide the enforceability of arbitration terms. *See Spinetti v. Service Corp. Int'l*, 324 F.3d 212, 216 n.1 (3d Cir. 2003); *Investment Partners*, 298 F.3d at 316; *Burden v. Check Into Cash*, 267 F.3d 483, 492-93 (6th Cir. 2001); *Shankle*, 163 F.3d at 1235; *accord Anders v. Hometown Mortgage Services, Inc.*, 346

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[4] In 1997, the Third Circuit issued an opinion holding that the enforceability of arbitration provisions addressing attorney's fees, statute of limitations, discovery, and punitive damages was for the arbitrator. *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222, 230-32 (3d Cir. 1997). But the court also seemed to substantively reject the argument that public policy precluded enforcement of the provisions. Regardless of the interpretation of this opinion, recent opinions in *Alexander, Spinetti v. Service Corp. International*, 324 F.3d 212, 216 n.1 (3d Cir. 2003), and *Harris v. Green Tree Financial Corp.*, 183 F.3d 173, 183-84 (3d Cir. 1999), clarify that, in the Third Circuit, courts determine the enforceability of arbitration terms.

F.3d 1024, 1028 (11th Cir. 2003) (although the Eleventh Circuit submits such issues to arbitrators, and did so in this case, the court stated that such challenges fall "within the category of 'gateway matters' which the Supreme Court has instructed us that courts and not arbitrators should decide.").

b. Four circuits allocate enforceability determinations to the arbitrator (First, Seventh, Eighth, Eleventh)

The Eleventh Circuit addressed the enforceability of an arbitration attorney's fee-shifting provision in *Thompson v. Irwin Home Equity Corp.*, 300 F.3d 88 (11th Cir. 2002), a case relied upon by the Eighth Circuit below. The *Thompson* Court held that the courts should only decide enforceability issues that are essential to determining whether an arbitration should occur, not the terms governing the arbitration. "'A court compelling arbitration should decide only such issues as are essential to defining the nature of the forum in which a dispute will be decided . . . .'" *Id.* at 91 (quoting *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083, 1085 (8th Cir. 2001)). Therefore, the enforceability issue was sent to the arbitrator to decide.

The last paragraph of the *Thompson* opinion, however, suggested that the issue of enforceability could be revisited by the courts after the arbitration.

> Arbitration is the correct initial forum for the Thompsons to air their objection to the attorney's fees provision in the arbitration agreement. If an arbitrator does award attorney's fees against the Thompsons, the district court would then be in a position to hear their argument that the challenged provision on attorney's fees is unenforceable because it deprives them of a statutory right.

300 F.3d at 92. This holding indicates that both arbitrators and the courts should determine the enforceability of some arbitration terms, although the applicable judicial standard of review and the source of authority for that review is unclear.

Like the Eleventh Circuit, the Eighth Circuit allocates to arbitrators the role of evaluating the enforceability of the terms of arbitration agreements. But it approaches judicial review of arbitrators' decisions differently. In the present case, the Court of Appeals relied upon its earlier decision in *Werries*, in which it concluded that an arbitrator should consider the enforceability of an arbitration provision that precluded punitive damages. The court concluded that the fee-shifting clause in the present case was like the punitive damage provision in *Werries*. "[The fee-shifting provision] is of the same ilk as the claim we considered in *Werries*. Therefore, the claim was properly presented to the arbitrator and not the District Court." 334 F.3d at 727 (footnote omitted), App. A-10.

But, unlike the Eleventh Circuit, the Eighth Circuit does not review an arbitrator's enforceability rulings. In the footnote omitted from the foregoing quote, the Eighth Circuit made this clear:

> We have no occasion to review the merits of the arbitrator's ruling on the validity of this provision. *See United Paperworkers Int'l Union v. Misco, Inc*, 484 U.S. 29, 38, 108 S.Ct. 364, 98 L.Ed.2d 286 (1987) (observing that courts "do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts . . . . As long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious

> error does not suffice to overturn his decision") . . . .

Id. at n.3, App. A-10. This is consistent with the District Court's conclusion that, in ruling on enforceability, an arbitrator is free to "interpret and apply the law, and to make mistakes in so doing . . . ." App. A-61.

The Eleventh Circuit takes a different approach that combines judicial and arbitral roles in deciding enforceability. In *Anders*, the court considered a party's contention that his arbitration agreement was unenforceable because it restricted the remedies available to him. The *Anders* Court held that this contention should be resolved by an arbitrator, but it was not writing on a clean slate regarding the issue. The Eleventh Circuit had previously held that a limitation on remedies rendered an arbitration agreement unenforceable, deciding the issue rather than leaving it to an arbitrator. *See Paladino v. Avnet Computer Tech., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998).

Reconciling its holding with *Paladino*, the *Anders* Court explained that if the unenforceable arbitration terms are not severable from the arbitration agreement, then the arbitration agreement as a whole is unenforceable and the enforceability issue must be resolved by the court. That was the outcome in *Paladino*. But if the arbitration terms at issue can be severed from the arbitration agreement, as was the case in *Anders*, then the enforceability issue is for the arbitrator. *Anders*, 346 F.3d 1024, 1029-30. Under *Anders*, therefore, the court first considers severability and then considers enforceability only if the provision is not severable.

The Seventh Circuit also splits enforceability determinations between the courts and arbitrators, but using a different criterion than the Eleventh Circuit. In the Seventh Circuit, the courts decide the enforceability of arbitration terms if the terms allegedly violate federal statutory rights. But the arbitrator decides enforceability if state common law

claims are at issue. *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003). The Seventh Circuit explained that, in its opinion, this was the correct approach in light of this Court's decision in *Gilmer*.

3. This Court should clarify the extent to which a district court's ruling on arbitrability under Section 4 of the FAA constrains the arbitrator's powers within the meaning of Section 10(a)(4) or the scope of the matters submitted to the arbitrator within the meaning of Section 11(b).

Under the FAA, a district court's section 4 ruling compels the parties to arbitration under the terms of their arbitration agreement. This logically defines the arbitration terms that are and are not enforceable, thereby establishing the powers of and the matters submitted to the arbitrator. Confusion about this analysis, however, has led to disagreements among the courts of appeals concerning the enforceability issues discussed above and led to the failure of the lower courts in this case to correct the Arbitrator's enforceability ruling, a ruling that effectively overruled the District Court's section 4 arbitrability order.

a. The FAA establishes a basic framework for pre- and post-arbitration actions in the district court.

Sections 4, 10, and 11 of the FAA establish the basic framework for the courts' role in enforcing arbitration agreements. Section 4 instructs the district court to determine whether an enforceable agreement to arbitrate exists. If an enforceable agreement exists, the district court must order the parties to proceed to arbitration in accordance with the terms of that agreement. 9 U.S.C. § 4.

Once the arbitrator has ruled on the parties' dispute, either party may then challenge the arbitrator's decision before the district court. Section 10 provides for arbitration

awards to be vacated "where the arbitrators exceeded their powers," or under other specified circumstances. 9 U.S.C. § 10(a). Similarly, section 11 provides for arbitration awards to be modified or corrected where the arbitrator "awarded upon a matter not submitted to them" or made other specified errors. 9 U.S.C. § 11.

By these sections, then, the FAA establishes a clearly-defined system for pre- and post-arbitration judicial review. It provides for the courts to establish the enforceable terms of an arbitration agreement pursuant to section 4 and to review an arbitrator's award under sections 10 and 11. Nothing in the FAA indicates that arbitrators have the authority to overrule the conclusions of the courts.

b. The various circuit courts have employed schemes for pre- and post-arbitration judicial review that fail to follow the FAA framework.

The Eleventh Circuit holds that courts should conduct post-arbitration review of an arbitration award to determine which terms of the arbitration agreement under which the arbitration was conducted are (or were) enforceable. *Thompson*, 300 F.3d at 92. In the Eighth Circuit, however, no post-arbitration review of an arbitrator's rulings on enforceability is permitted. *Bob Schultz Motors*, 334 F.3d at 727 n.3, App. A-10.

Neither analysis is consistent with the FAA. Contrary to the conclusions of both circuits, enforceability determinations are made when a court rules on arbitrability and sends a dispute to arbitration "in accordance with the terms" of the parties' agreement. 9 U.S.C. § 4. Contrary to the conclusion of the Eleventh Circuit, sections 10 and 11 of the FAA do not provide for post-arbitration enforceability determinations.

Despite the lack of authority for post-arbitration evaluation of enforceability issues, the FAA does permit post-arbitration review to assure that sufficiently important rights and interests are preserved in the arbitration process. "[T]he question of public policy is ultimately one for resolution by the courts. . . . If the contract as interpreted by [the arbitrator] violates some explicit public policy, we are obliged to refrain from enforcing it." *W.R. Grace & Co. v. Local Union 759*, 461 U.S. 757, 766 (1983); *see also Mitsubishi*, 473 U.S. at 638 ("Having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed.").

Post-arbitration review also ensures that the arbitrator has complied with applicable court orders – another important public policy. "It is beyond question that obedience to judicial orders is an important public policy." *W.R. Grace*, 461 U.S. at 766.

Moreover, the FAA expressly provides that an arbitrator is constrained by his "power" (section 10(a)(4)) and the "matter . . . submitted" to him (section 11(b)). Although these constraints are usually found in the parties' arbitration agreement, the validity and enforceability of that agreement is governed by court orders. 9 U.S.C. §§2, 4. *A fortiori*, the arbitrator's power and the matter submitted to him or her are governed by court orders. *See Brown v. Witco Corp.*, 340 F.3d 209, 221 (5th Cir. 2003) (arbitrator's award that exceeded scope of court's order vacated).

In this case, the District Court and the Court of Appeals sanctioned the Arbitrator's enforceability ruling, which was based upon a fundamental disagreement with a prior court order. These actions by the courts and the Arbitrator were inconsistent with the FAA. If the District Court had erred in its enforceability analysis, that was an

issue to be resolved by the courts, not the Arbitrator. When the Arbitrator purported to rule upon the issue, he exceeded his powers and ruled upon a matter not submitted to him. By refusing to vacate or modify the award, the lower courts acted inconsistently with the FAA and with cases such as *W.R. Grace* and *Brown* that recognize the primacy of court orders.

Clarification of the role of the courts and arbitrators under the FAA also would resolve an analytical disagreement between the Eleventh and Seventh Circuits. Both of these courts permit arbitrators to determine the enforceability of some arbitration terms, but they disagree about which enforceability issues go to the arbitrator. In the Seventh Circuit, federal courts determine the enforceability of arbitration terms that allegedly violate federal rights, but not those that violate state rights. *Hawkins*, 338 F.3d at 807. In the Eleventh Circuit, courts determine the enforceability of arbitration terms that are not severable from the arbitration agreement, but arbitrators decide the enforceability of severable arbitration terms. *Anders*, 346 F.3d 1024, 1029-30. These distinctions do not exist in the FAA, and this Court's clarification of the importance of following the statutory scheme will resolve this and other disagreements among the courts of appeals.

CONCLUSION

The opinions of the courts of appeals are inconsistent among themselves, with the FAA, and with rulings of this Court. The FAA embodies a federal policy encouraging arbitration according to the terms of arbitration agreements. Consistency among the courts of appeals concerning the application of this statute and the respective roles of the courts and arbitrators is necessary to ensure that federal law does in fact encourage arbitration. Action by this Court is necessary to achieve this consistency. Kawasaki therefore respectfully requests that this Court grant this petition for a writ of certiorari.

Respectfully submitted,

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November 10, 2003

United States Court of Appeals,
Eighth Circuit.

BOB SCHULTZ MOTORS, INC., a Missouri corporation,
Appellee,

v.

KAWASAKI MOTORS CORPORATION, U.S.A., a
Delaware corporation, Appellant.

No. 02-2323.

Appeal from the United States District Court
for the Eastern District of Missouri

Submitted: Dec. 11, 2002.

Filed: July 1, 2003.

Before BOWMAN, MORRIS SHEPPARD ARNOLD, and RILEY, Circuit Judges.

BOWMAN, Circuit Judge.

This dispute between a motorcycle dealer, Bob Schultz Motors (Schultz), and its distributor, Kawasaki, was submitted to arbitration pursuant to the "Dealer Sales and Service Agreement" that governed the parties' relationship. The arbitrator ruled in favor of Kawasaki on all counts. However, following a hearing on costs and attorney fees allowed under the arbitration provision, the arbitrator ruled that the last sentence in the arbitration provision, which awarded costs and fees to the prevailing party, was unconscionable, was a contract of adhesion, and was therefore unenforceable. The District Court[1] confirmed the

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[1] The Honorable Charles A. Shaw, United States District Judge for the Eastern District of Missouri.

arbitrator's ruling in its entirety and Kawasaki appealed. We have jurisdiction pursuant to 9 U.S.C. § 16(a)(1)(d) (2000) and affirm.

I.

This decade-long dispute involves an attempt by Bob Schultz Motors and its owner, William Wefel, to acquire a third Kawasaki motorcycle dealership in the St. Louis region. Schultz brought suit in Missouri state court and alleged, inter alia, that Kawasaki wrongfully refused to consent to its purchase of West County Kawasaki from John and Betty Catanzaro in 1992. Kawasaki removed the action to federal court based on diversity jurisdiction and moved to have the suit dismissed or, in the alternative, to have the matter referred to arbitration pursuant to 9 U.S.C. § 4. Kawasaki based this motion on the parties' "Dealer Sales and Service Agreement," ¶ 32 of which provided:

> 32. DISPUTE RESOLUTION.
>
> All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR [Kawasaki], relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claims or disputes, except those expressly excluded above. Judgement upon such award may be entered in the Superior Court of the State of California for the County of

> Orange, if the award is rendered against DISTRIBUTOR, or in any court which has jurisdiction over DEALER [Schultz], if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys' fees.

The District Court dismissed two counts of Schultz's complaint and issued an order compelling arbitration on the remaining counts. Importantly, the District Court also rejected Schultz's claim that the distribution agreement was a contract of adhesion, violated public policy, and was unconscionable. The District Court concluded that "no legal constraints exist which foreclose arbitration of the disputes" and "Schultz Motors has failed to show that Kawasaki's arbitration clause is unconscionable or inherently unfair." Memorandum and Order at 13, 8 (March 30, 1994). The District Court did not make a finding as to Schultz's claim of economic duress, which was later dropped, but did note that "[i]f this issue were a matter for the Court's determination, the Court would conclude Schultz Motors has failed to show it entered into the franchise agreements under economic duress of the kind which requires a court to intervene." *Id.* at 8.

Thereafter, in 1995, as arbitration was about to commence, Schultz added counts to its arbitration complaint that alleged Kawasaki wrongfully refused to allow Schultz to relocate one or both of its existing dealerships to within a few blocks of a another recently-established Kawasaki dealership. In 2000, the arbitrator issued a "Ruling on Liability Issues" that found in favor of Kawasaki on all counts and ruled that, pursuant to the parties' arbitration agreement, Kawasaki was a prevailing party and was entitled to costs and attorney fees. However, in 2001, following a hearing on the amount of arbitration costs and attorney fees to be assessed against Schultz (some $1.7 million according to Kawasaki), the

arbitrator issued a "Final Award" in which he found that the franchise agreement was a contract of adhesion and "that the arbitration agreements were unconscionable at the time they were made and [the arbitrator] refuses to enforce the provision in ¶ 32 which gives the prevailing party the right to recover all costs and expenses of the arbitration, including without limitation, attorneys' fees." Final Award of Arbitrator at 8 (January 31, 2001).

Neither party was satisfied with the outcome of the arbitration proceedings and both parties returned to the District Court where Kawasaki filed a Motion to Confirm the Arbitration Award as to Liability and Vacate and/or Modify the Arbitration Award as it Pertains to Attorney's Fees. For its part, Schultz Motors sought to vacate the entire award. In its March 2002 ruling, the District Court confirmed the arbitrator's award in its entirety and concluded that the arbitrator was correct when it determined that the District Court's 1994 ruling, which held that ¶ 32 was a valid arbitration provision under 9 U.S.C. § 4, had not addressed the validity of the last sentence of ¶ 32. We agree.

II.

We are to apply "ordinary, not special, standards when reviewing district court decisions upholding arbitration awards." *First Options of Chicago, Inc. v. Kaplan,* 514 U.S. 938, 948, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995). Thus, we review a district court's findings of fact for clear error and conclusions of law de novo. *Id.* at 947-48, 115 S.Ct. 1920.

The purpose of the Federal Arbitration Act was to establish "a liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). A court asked to confirm, modify, or vacate an arbitrator's award owes the arbitrator's decision great deference. *See, e.g., Osceola County Rural Water Sys. v. Subsurfco, Inc.,* 914 F.2d 1072, 1075 (8th Cir. 1990). Thus, the Federal

Arbitration Act provides that a district court can vacate an arbitration award only in limited circumstances:

> (1) Where the award was procured by corruption, fraud, or undue means.
>
> (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
>
> (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
>
> (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a).[2] In addition to § 10's grounds for vacating an arbitrator's award, § 11 provides for three

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[2] In addition, the Supreme Court has recognized a narrow public policy exception that permits the reviewing court to decline to enforce an arbitration award that contravenes "explicit public policy." *W.R. Grace & Co. v. Local Union 759, Int'l Union of the United Rubber Workers,* 461 U.S. 757, 766, 103 S.Ct. 2177, 76 L.Ed.2d 298 (1983). The "public policy, however, must be well defined and dominant, and is to be ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.' " *Id.* (quoting *Muschany v. United States,* 324 U.S. 49, 66, 65 S.Ct. 442, 89 L.Ed. 744 (1945)). Thus, in *Iowa Electric Light & Power Co. v. Local Union 204,* 834 F.2d 1424 (8th Cir.1987), we declined to enforce an arbitration award that would have reinstated a union member in his job at a nuclear power plant after he was dismissed for violating safety regulations designed to contain radiation in the event of a disaster. In that case, we had little trouble concluding that the federal regulations requiring the safety measures that the employee had violated amounted to a "strong public policy" that required us to refuse to enforce the arbitration award. *Id.* at 1427-28.

grounds upon which a reviewing court may modify the arbitrator's award:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

9 U.S.C. § 11. In sum, Congressionally-mandated deference to arbitration proceedings means that a "district court must take the award as it finds it and either vacate the entire award using section 10 or modify the award using section 11." *Legion Ins. Co. v. VCW, Inc.*, 198 F.3d 718, 721 (8th Cir. 1999). Still, the deference owed to arbitrators "is not the equivalent of a grant of limitless power." *Leed Architectural Prods., Inc. v. United Steelworkers of Am., Local 6674,* 916 F.2d 63, 65 (2d Cir. 1990). And "the courts are neither entitled nor encouraged simply to 'rubber stamp' the interpretations and decisions of arbitrators." *Matteson v. Ryder Sys. Inc.*, 99 F.3d 108, 113 (3d Cir. 1996). With this in mind, we turn to the merits of Kawasaki's appeal.

Faced with these statutory limitations on a court's ability to review arbitration awards, Kawasaki urges that the District Court erred in one of two ways. First, it claims that the arbitrator's decision should be modified under § 11(b) because the District Court addressed the validity of ¶ 32 (the arbitration provision) in its 1994 Order. Therefore, Kawasaki argues, the arbitrator "awarded upon a matter not submitted to [it]" when it determined that the fee provision was unconscionable. Second, Kawasaki argues that, in the event that § 11(b) is inapplicable, the arbitrator essentially issued two separate rulings. Thus, as the logic goes, the

arbitrator's second, independent, award on fees should be vacated under § 10(a)(4) because the District Court addressed the validity of ¶ 32 (the arbitration provision) in its March 1994 Order. Hence, Kawasaki urges that the arbitrator "exceeded [its] powers" when it ruled that the fee provision was unconscionable. We disagree and conclude that the District Court did not err when it affirmed the arbitrator's ruling in its entirety.

Whether or not the arbitrator issued one ruling or two, we would not set aside the District Court's decision as erroneous. Rather, the Federal Arbitration Act and existing case law require that we reach the opposite conclusion.

The Supreme Court has repeatedly noted that the Federal Arbitration Act was designed to combat longstanding hostility to arbitration by establishing "a liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem. Hosp.,* 460 U.S. at 24, 103 S.Ct. 927; *see also Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. 213, 220 n. 6, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985). The Act instructs district courts to enforce the parties' decision to remove their controversy from the judicial realm and have it decided by arbitration. *Byrd,* 470 U.S. at 218, 105 S.Ct. 1238. Thus, the Act requires that when a party petitions for an order to compel arbitration, "[t]he court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement." 9 U.S.C. § 4. Although § 4 imbues the federal courts with only limited powers in the context of a party's motion to compel arbitration, it is clear that the validity of the arbitration clause and its applicability to the dispute at hand are questions for the district court to decide. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395, 403-04, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967); *Houlihan v.*

Offerman & Co., 31 F.3d 692, 694-95 (3th Cir. 1994) ("under the Federal Arbitration Act, the district court must engage in a limited inquiry to determine whether a valid agreement to arbitrate exists between the parties and whether the specific dispute falls within the scope of that agreement"). However, this determination as to whether the parties agreed to arbitrate their dispute is also the end of a district court's powers. *See Prima Paint,* 388 U.S. at 403-04, 87 S.Ct. 1801. If the parties have agreed to arbitrate their dispute, other claims are for the arbitrator to decide. *See id.* at 404, 87 S.Ct. 1801. *Prima Paint* makes it clear that under the Federal Arbitration Act, the parties are limited to presenting claims to the court that the arbitration agreement is invalid or does not apply by its terms to the present dispute. If the parties have agreed to arbitration, the Act requires that a district court order them to proceed to that forum, where they must address all other claims to the arbitrator.

We applied the foregoing principles in *Larry's United Super, Inc. v. Werries,* 253 F.3d 1083 (8th Cir. 2001). The issue in *Werries* was whether the public policy underlying the availability of punitive damages under the Racketeer Influenced and Corrupt Organizations Act might prevent a district court from ordering arbitration of a dispute where the parties' arbitration agreement waived punitive damages and other relief. *Id.* at 1084-85. We held that the district court's duty was limited to determining whether the parties had agreed to arbitrate and whether that agreement was valid. Thus, the party seeking to void the provisions waiving punitive damages and other relief had to address those arguments to the arbitrator. *Id.* at 1085-86. We think the same logic applies in this case and note that at least two other courts of appeal have held that it is for the arbitrator to consider challenges to attorney-fee provisions or other limits on remedies in arbitration provisions. *See Thompson v. Irwin Home Equity Corp.*, 300 F.3d 88, 92 (1st Cir. 2002)

("Arbitration is the correct initial forum for the Thompsons to air their objection to the attorney's fees provision in the arbitration agreement."); *Great W. Mortgage Corp. v. Peacock,* 110 F.3d 222, 230-31 (3d Cir.), *cert. denied,* 522 U.S. 915, 118 S.Ct. 299, 139 L.Ed.2d 230 (1997); *cf. Metro E. Ctr. v. Qwest Communications, Inc.,* 294 F.3d 924, 929 (7th Cir.) ("If the provision in the tariff calling for use of the American Rule is unlawful under the Communications Act, then the right forum for complaint is the Federal Communications Commission--though it is conceivable that the arbitrator may play a role too."), *cert. denied,* 537 U.S. 1090, 123 S.Ct. 707, 154 L.Ed.2d 634 (2002).

Schultz's claim that the last sentence of ¶ 32, which provides that "[t]he prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys' fees," is unconscionable is based upon the public policy underlying California's unconscionability jurisprudence and is of the

same ilk as the claim we considered in *Werries.*[3] Therefore, the claim was properly presented to the arbitrator and not the District Court. It follows that the District Court properly concluded that its March 1994 Order compelling arbitration dealt only with "the issue of arbitrability, *i.e.,* whether the arbitration provision between the parties should be enforced to require their dispute to be arbitrated. Memorandum and Order at 10 (March 26, 2002). The Court did not address the attorney fee provision, which was not mentioned in any of the parties' pleadings at the time." *Id.* Indeed, had the District Court concluded otherwise, its ruling would have addressed matters other than whether the parties agreed to arbitrate their dispute (and whether that agreement was valid). As such, the decision would have thwarted Congress's intent to allow parties that contract to have their conflicts settled outside the judicial realm to have these

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[3] We have no occasion to review the merits of the arbitrator's ruling on the validity of this provision. *See United Paperworkers Int'l. Union v. Misco, Inc.,* 484 U.S. 29, 38, 108 S.Ct. 364, 98 L.Ed.2d 286 (1987) (observing that courts "do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts.... as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision"); *but see First Options,* 514 U.S. at 942, 115 S.Ct. 1920 (noting that "parties [are] bound by arbitrator's decision not in 'manifest disregard' of the law") (quoting *Wilko v. Swan,* 346 U.S. 427, 436-37, 74 S.Ct. 182, 98 L.Ed. 168 (1953), *overruled on other grounds by Rodriguez de Quijas v. Shearson/American Express, Inc.,* 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989)).

contracts enforced and would be inconsistent with the Supreme Court's decision in *Prima Paint* and our decision in *Werries.*

Our decision in *Gannon v. Circuit City Stores, Inc.,* 262 F.3d 677 (8th Cir. 2001), also lends support to our conclusion. In that case, Circuit City appealed a decision by the district court that denied its motion to compel arbitration because a provision in the parties' arbitration agreement violated Missouri public policy by limiting the amount of punitive damages available under Missouri's Human Rights Act. The sole issue on appeal was whether the district court erred by not severing the invalid provision (based on the severability clause in the contract and Missouri common law) and ordering the parties to proceed to arbitration on the remaining valid provisions. *Id.* at 680. Crucial to understanding the outcome in *Gannon* is the fact that the parties did not challenge the district court's determination that the provision was invalid. *Id.* at 680-81. Further, we acknowledged in *Gannon* that the fact that the district court resolved this issue at all was in tension with our earlier decision in *Werries,* which we noted stood for the proposition that such matters were "for arbitrators, not the courts, to decide in the first instance." *Id.* at 681 n. 6. Thus, the rule in the Eighth Circuit, as established by *Werries* and recognized in *Gannon,* is that in the context of a motion to compel arbitration under the Federal Arbitration Act, the district court is limited to considering the parties' claims that the arbitration agreement is invalid or that it does not apply to the dispute with respect to which arbitration is sought. Thereafter, once the parties have proceeded to arbitration, they must address their claims to the arbitrator.

III.

For the reasons stated above, we affirm the decision of the District Court confirming the arbitrator's award in its entirety.

United States District Court
Eastern District of Missouri
Eastern Division.

BOB SCHULTZ MOTORS, INC., Plaintiff,

v.

KAWASAKI MOTORS CORPORATION, U.S.A., Defendant.

No. 4:93-CV-807 CAS

MEMORANDUM AND ORDER

This matter is before the Court on a motion conference held February 24, 1994.

Defendant Kawasaki Motors Corporation, U.S.A. ("Kawasaki") informed the Court that its Motion for Additional Time to Respond and Motion for Leave to File Brief in Excess of 15 Pages have previously been resolved.

The Court heard the parties' arguments addressed to Kawasaki's Motion to Dismiss or for Other Relief. At the hearing, Kawasaki did not emphasize to the court the dispositive nature of the portion of its Motion requesting a stay of the proceedings and to compel arbitration. In deciding whether to submit a particular grievance to arbitration, a court is not to rule on the potential merits of the underlying claims. A.T. & T. Technologies, Inc. v. Communications Workers of America, 475 U.S. 643, 649 (1986). The merits of the dispute and whether the failure to meet any prerequisite will bar recovery are for the arbitrator to decide. Contracting Northwest, Inc. v. City of Fredericksburg, 713 F.2d 382, 184 (8th Cir. 1983); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983).

The Court denied Kawasaki's Motion to Dismiss to the extent it is directed to Count I of the Complaint, granted

the Motion to Dismiss to the extent it is directed to Counts II and III of the Complaint, and took the motion under submission with regard to Counts IV and V. The Court now having considered Kawasaki's motion requesting a stay of the proceedings and to compel arbitration, the foregoing rulings will be vacated in accordance with the standards set forth above and the discussion below.

Arbitration.

Count V of the Complaint seeks a declaration that an arbitration clause contained in franchise agreements between plaintiff Bob Schultz Motors, Inc. ("Schultz Motors") and Kawasaki is unenforceable. Kawasaki asks the Court to stay this proceeding and refer it to arbitration in California under the franchise agreements between the parties and the Federal Arbitration Act, 9 U.S.C. § 1 et seq. (''FAA''). The Court therefore treats Kawasaki's motion as a motion to compel arbitration under 9 U.S.C. § 4.9 U.S.C. § 6; Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 23 n.27 (1983).

The FAA declares that a written provision for arbitration in any contract "evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Section 2 comprises a liberal federal policy favoring arbitration agreements. Moses H. Cone, 460 U.S. at 24. The effect of Section 2 is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the FAA. Id.

Section 3 of the FAA requires a federal court in which a suit has been brought "upon any issue referable to arbitration under an agreement in writing for such arbitration" to stay the court action pending arbitration once it is satisfied that the issues are arbitrable under the

agreement. Section 4 provides a federal remedy for a party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under the written agreement for arbitration," and directs the court to order arbitration once it is satisfied that an agreement for arbitration has been made and has not been honored.

There are only two limitations on the enforceability of an arbitration provision covered by the FAA: (i) It must be part of a written contract "evidencing a transaction involving commerce''; and (ii) it may be revoked only upon "grounds as exist at law or in equity for the revocation of any contract." Southland Corp. v. Keating, 465 U.S. 1, 10-11 (1984), quoting 9 U.S.C. § 2. Federal law preempts state law with respect to the interpretation and construction of arbitration agreements falling within the scope of the FAA. Webb v. R. Rowland & Co., Inc., 800 F.2d 803, 806 (8th Cir. 1986).

The first step in the Court's analysis is to determine whether the franchise agreements between the parties are subject to the FAA. The Court concludes the franchise agreements in this case are contracts "evidencing a transaction involving commerce" within the meaning of 9 U.S.C. § 2. The FAA specifies that commerce means "commerce among the several States," i.e. interstate commerce. 9 U.S.C. § 1. The franchise agreements at issue in this case are between Schultz Motors, a Missouri corporation, and Kawasaki, a Delaware corporation with its principal place of business in California, for the distribution and sale of Kawasaki motor vehicle products shipped to Missouri from elsewhere. See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 616-618 (1985). Thus, the arbitration clause contained in the franchise agreements is covered by the FAA.

Scope.

The Court must now determine whether the parties agreed to arbitrate the dispute. The Court is to make this determination by applying the federal substantive law of arbitrability. Mitsubishi Motors, 473 U.S. at 626, citing Moses H. Cone, 460 U.S. at 24. Questions of arbitrability "must be addressed with a healthy regard for the federal policy favoring arbitration." Moses H. Cone, 460 U.S. at 24. As a matter of federal law, any doubts concerning the scope of arbitrable issues are resolved in favor of arbitration, whether the problem is construction of the contract language itself or an allegation of waiver, delay, or similar defense to arbitrability. Id. at 24-25.

As with any other contract, the parties, intentions control, but those intentions are generously construed as to issues of arbitrability. Id.; Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1289 (8th Cir. 1984), citing United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960). The Court must ascertain whether the parties intended the instant dispute to be arbitrated, as evidenced by the language contained in the franchise agreements.

The arbitration clause states:

> 32. DISPUTE RESOLUTION
>
> All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR [Kawasaki], relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in

> accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, (claim or disputes, except those expressly excluded above. Judgement (sic) upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against DISTRIBUTOR, or in any court which has jurisdiction over DEALER [Schultz Motors], if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys, fees.

The language of this clause is broad and contemplates that most disputes between the parties will be arbitrated, with certain exceptions not applicable here. The Court now determines whether the various counts of the Complaint concern disputes which fall within the scope of the arbitration clause.

Count I asserts a claim for breach of Kawasaki's implied covenant of good faith and fair dealing under the franchise agreements, and thus concerns a dispute clearly within the scope of the arbitration clause.

Count II is a claim for tortious interference with contract. In this count, Schultz Motors asserts that Kawasaki tortiously interfered with a sale agreement between Schultz Motors and Catanzaro Enterprises, Inc. ("Catanzaro"), another Kawasaki franchisee, by refusing to give its consent to the sale. In Count III, Schultz Motors contends it is a third-party beneficiary of the franchise agreements between

Kawasaki and Catanzaro, and alleges a breach of those agreements by virtue of Kawasaki's refusal to consent to the Schultz Motors-Catanzaro sale agreement.

The Court concludes the claims in Counts II and III do not concern disputes within the scope of the arbitration agreement, as they do not arise from the franchise agreements between Schultz Motors and Kawasaki. The Court further concludes that its previous order dismissing these counts should be reinstated.

Count IV is a claim that Kawasaki's refusal to consent to the Schultz Motors-Catanzaro sale constitutes an unlawful practice under the Missouri Motor Vehicle Franchise Practices Act. Schultz Motors' claim in this count derives from its status as a Kawasaki motor vehicle franchisee. Resolving any doubts concerning the scope of arbitration in favor of arbitration, as it must, the Court concludes the arbitration clause governs this aspect of the dispute between the parties.

Defenses.

The Court now addresses Schultz Motors' contention that the arbitration clause is unenforceable for various reasons which would provide grounds "for the revocation of any contract." 9 U.S.C. § 2. Schultz Motors' first assertion is that the franchise agreements were signed under economic duress. Where an agreement to arbitrate was obtained by "overwhelming economic power" it may be set aside. Mitsubishi Motors, 473 U.S. at 627. Whether duress exists must be determined on a case-by-case basis, but a finding of duress must "reflect a conviction that one party to a transaction has been so improperly imposed upon by the other that a court should intervene." Hellenic Lines, Ltd. v. Louis Dreyfus Corp., 372 F.2d 753, 758 (2nd Cir. 1957); Restatement (Second) of Contracts § 176, cmts. a, f (1979).

Schultz Motors states that its original franchise agreements with Kawasaki did not contain arbitration clauses, and that it entered into subsequent franchise agreements containing an arbitration clause only under economic duress. The Court has reviewed the affidavit of William C. Wefel, which states that "Kawasaki exercised superior bargaining strength in negotiating the franchise contracts," and describes Schultz Motors' investment and expenditures in developing its Kawasaki franchise.[4]

Schultz Motors' claims regarding duress should be decided by an arbitrator, not the Court, since they go to the formation of the entire franchise agreement rather than to the issue of the arbitration clause. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu, 637 F.2d 391, 398 (5th Cir. 1981) ; see also Prima Paint Corp. v. Flood & Conklin, 388 U.S. 395, 402-406 (1966) (question of fraud in the inducement of an entire contract is a question for the arbitrator.) If this issue were a matter for the Court's determination, the Court would conclude Schultz Motors has failed to show it entered into the franchise agreements under economic duress of the kind which requires a court to intervene.

The Court rejects Schultz Motors' argument that the franchise agreements are contracts of adhesion. "The use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision. To be invalid, the provision at issue must be unconscionable." Webb, 800 F.2d at 807, quoting Surman v. Merrill Lynch, Pierce, Fenner & Smith,

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[4] The affidavit also states that Schultz Motors is a franchisee of Honda, Yamaha, Suzuki and Harley-Davidson. Presumably some of the money and effort expended by Schultz Motors benefited these franchises as well as the Kawasaki franchise.

733 F.2d 59, 61 n.2 (8th Cir. 1984). The Eighth Circuit has held there is nothing inherently unfair about arbitration clauses, and they are therefore valid and enforceable. Surman, 733 F.2d at 61 n.2. Schultz Motors has failed to show that Kawasaki's arbitration clause is unconscionable or inherently unfair.

Nor does the Court agree that the arbitration clause lacks mutuality of obligation. In order for there to be sufficient mutuality, it is not essential that both parties be required to arbitrate every type of claim which may arise under an agreement. It is sufficient if both parties agree to arbitrate some claims. Hull v. Norcom, Inc., 750 F.2d 1547, 1548-1550 (11th Cir. 1985), citing Riccardi v. Modern Silver Linen Co., Inc., 356 N.Y.S.2d 872, 875-876 (N.Y. App. Div. 1986); Seymour v. Gloria Jean's Coffee Bean Franchising Corp., 732 F. Supp. 988, 995-996 (D. Minn. 1990). In this case, the parties agreed to arbitrate most claims either might have arising under the franchise agreements, with a few exceptions. As a result, sufficient mutuality of obligation exists. See C.H.I., Inc. v. Marcus Brothers Textile, Inc., 930 F.2d 762, 764 (9th Cir. 1991).

Schultz Motors next argues the arbitration clause violates Missouri public policy as expressed in the Missouri Motor Vehicle Franchise Practices Act, RSMo. § 407.810 et seq. (1986) (the "Act"). Schultz Motors asserts that claims under the Act must be litigated in Missouri courts rather than arbitrated, or at minimum arbitrated in Missouri, citing RSMo. § 407.820. The Court disagrees. The Act is silent as to arbitration, and the section cited by Schultz Motors provides only, that motor vehicle franchisors doing business with motor vehicle franchisees with a place of business in the State of Missouri shall be subject to the jurisdiction of Missouri's courts.

There is no reason to depart from the well-established guidelines governing agreements subject to the FAA where a

party bound by an arbitration agreement raises claims based on statutory rights. Mitsubishi Motors, 473 U.S. at 626. The Court stated in Mitsubishi that arbitration of such claims does not violate statutory goals:

> By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.

Id. Having agreed to the arbitration clause, Schultz Motors must be held to its agreement.

Waiver.

Finally, Schultz Motors asserts that Kawasaki has waived any right to compel arbitration by removing this suit to federal court, and filing a Motion to Dismiss directed to all counts. Waiver is not to be lightly inferred, and mere invocation of the judicial process is insufficient to constitute waiver. Rush v. Oppenheimer & Co., 779 F.2d 885, 887 (2nd Cir. 1985) (citations omitted). Doubts concerning waiver of arbitrability are to be resolved in favor of arbitration. Ritzel Communications, Inc. v. Mid-American Cellular Telephone Co., 989 F.2d 966, 969 (8th Cir. 1993). However, waiver will be found where the party claiming the right to arbitrate (i) knew of an existing right to arbitration; (ii) acted inconsistently with that right; and (iii) prejudiced the other party by its inconsistent acts. Stifel, Nicolaus & Co. , Inc. v. Freeman, 924 F.2d 157, 158 (8th Cir. 1991). Whether there is waiver depends on the facts of each case. Ritzel, 989 F.2d at 971.

There is no dispute Kawasaki knew of its right to arbitration. At issue is whether Kawasaki took action inconsistent with this right. Kawasaki removed the action

from state court, and then filed a motion to dismiss which included a request that the matter be referred for arbitration. Extensive briefing by the parties ensued directed to all counts of the Complaint, but no discovery has taken place.

Removal of a case does not preclude the rights of a party seeking arbitration. M & I Electric Industries, Inc. v. Rapistan Demag Corp., 814 F. Supp. 545, 547 (E.D. Tex. 1993), citing Garner Lumber Co. v. Randolph E. Valensi, Lange, Inc., 393 F. Supp. 161, 163 (D.C.N.Y.), aff'd, 513 F.2d 1171 {4th Cir. 1975) ; Lee v. Grandor Medical Systems, Inc., 702 F. Supp. 252, 255 (D. Colo. 1988); see e.g. Gavlik Construction Co. v. H. F. Campbell Co., 526 F.2d 777, 780 {3rd Cir. 1975). Thus, Kawasaki's removal of the action does not constitute a waiver.

The filing of a motion to dismiss alone does not waive the right to arbitrate, especially where there is a multi-count complaint containing claims which are arguably non-arbitrable. Rush, 779 F.2d at 888, citing Sweater Bee By Banff, Ltd. v. Manhattan Industries, Inc., 754 F.2d 457, 463 (2nd Cir.), cert. denied, 474 U.S. 819 (1985). The Seventh Circuit has stated that in such a case, a party may need to file a motion to dismiss to sort out the claims before it can intelligently decide whether to arbitrate, and to protect its rights in court if the claims are held to be non-arbitrable. St. Mary's Medical Center v. Disco Aluminum Products, 969 F.2d 585, 588-589 (7th Cir. 1992).

The Eighth Circuit found waiver where a party (i) filed a motion to dismiss or in the alternative to sever a cross-claim for separate trial; (ii) did not move to stay the proceedings and compel arbitration until six weeks later; and (iii) proceeded to trial when its motion for a stay and to compel was denied. Ritzel, 989 F.2d at 969. The Court described the motion to dismiss as a "substantial, active invocation of the litigation process," which "initiated steps in the litigation and required responsive actions by [the other

party] rather than immediately demanding arbitration." Id. However, the Ritzel decision appears to turn on factors of prejudice and mootness, as the moving party failed to seek a stay in the appellate court and fully litigated its case in the district court before the appeal was decided. Id. at 970-971.

Given that doubts concerning waiver of arbitrability are to be resolved in favor of arbitration, the Court concludes Kawasaki's action in filing a motion to dismiss was not inconsistent with its right to arbitration. The Complaint contained multiple counts, some of which this Court has found to be non-arbitrable. Compare St. Mary's Medical Center, 969 F.2d at 588-589. Unlike the situation in Ritzel, Kawasaki submitted its request for arbitration together with the motion to dismiss, and thus did not delay in seeking its remedy of arbitration.

Finally, the Court concludes that even if Kawasaki's actions were inconsistent with its right to arbitration, there is no basis for a finding of prejudice resulting to Schultz Motors from these actions. As previously noted, no discovery has occurred in this case, and the parties, briefs concerning those issues the Court has found to be arbitrable may be submitted to the arbitrator.

Consequently, the Court has concluded that (i) Counts II and III of the Complaint should be dismissed; (ii) the franchise agreements between the parties are subject to the FAA; (iii) the parties agreed to arbitrate the disputes in Counts I and IV of the Complaint; and {iv} no legal constraints exist which foreclose arbitration of the disputes. Pursuant to the express directive of section 3 of the FAA, 9 U.S.C. § 3, any further action in the instant matter will be stayed pending the outcome of the parties, arbitration.

Accordingly,

IT IS HEREBY ORDERED that defendant's Motion for Additional Time to Respond and Motion for

Leave to File Brief in Excess of 15 Pages are **DENIED** as moot. [Doc. 3, 4]

IT IS FURTHER ORDERED that defendant's Motion to Dismiss is **GRANTED** as to Counts II and III of the Complaint. [Doc. 5]

IT IS FURTHER ORDERED that defendant's motion as directed to Count V of the Complaint, converted by the Court sua sponte to a motion to compel arbitration, is **GRANTED** as to all remaining counts of plaintiff's Complaint. [Doc. 5]

IT IS FURTHER ORDERED that because Counts I and IV are subject to arbitration, defendant's Motion to Dismiss directed to Counts I and IV is **DENIED** without prejudice to refiling. [Doc. 5]

IT IS FURTHER ORDERED that an arbitration proceeding shall be filed within six (6) months of the date of this Order. Failure to actively pursue arbitration may result in dismissal of this action for failure to follow the Court's Orders.

IT IS FURTHER ORDERED that within sixty (60) days of the initiation of arbitration proceedings, and every sixty (60) days thereafter, the parties shall file a joint report advising the Court of the status of the proceedings.

IT IS FURTHER ORDERED that within eleven (11) days of the conclusion of the arbitration proceeding, plaintiff shall file a report advising the Court of the resolution of the arbitration proceeding and of its effect on plaintiff's claims against defendant.

IT IS FINALLY ORDERED that further action in the present case is **STAYED** pending the disposition of the arbitration of the remaining counts of plaintiff's Complaint.

(Signature omitted in printing)

CHARLES A. SHAW
UNITED STATES DISTRICT JUDGE

Dated this 30th day of March, 1994.

United States District Court
Eastern District of Missouri
Eastern Division.

BOB SCHULTZ MOTORS, INC., Plaintiff,

v.

KAWASAKI MOTORS CORPORATION, U.S.A., Defendant.

No. 4:93-CV-807 CAS

MEMORANDUM AND ORDER

This matter is before the Court on plaintiff's Motion for Instructions to the Arbitrator. Document 28.

On March 30, 1994, this Court granted defendant's motion to compel arbitration pursuant to an arbitration clause contained in the parties' franchise agreement. The Court denied without prejudice defendant's motion to dismiss plaintiff's claims for breach of the agreement's implied covenant of good faith and fair dealing (Count I) and for unlawful practices under the Missouri Motor Vehicle Franchise Practices Act ("MMVFPA") (Count IV). In that same order, the Court concluded that plaintiff's claims for tortious interference with contract and breach of a third-party beneficiary contract, Counts II and III, were not within the scope of the arbitration agreement, and in any event, failed to state a claim for relief.[5] Accordingly, the Court dismissed those counts. Document 18.

After this case was referred to arbitration, plaintiff obtained leave to file an amended demand. Included in the

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[5] The claims were premised on defendant's alleged wrongful refusal to consent to the sale of a Kawasaki franchise from Catanzaro Enterprises to plaintiff.

amended demand are claims alleging breach of contract and violation of the MMVFPA which were not asserted in the original complaint (Counts VII, VIII), and variations on the tortious interference and third-party beneficiary claims previously dismissed by this Court (Counts II, III, IV). Document 28, exh. B. Defendant moved to dismiss both the new claims and the old claims. Alternatively, defendant moved to stay arbitration pending this Court's determination of the viability of the old claims and the arbitrability of the new claims. Id., exh. A at 4. On April 17, 1995, the Arbitrator stayed further proceedings and requested this Court to consider the counts set forth in the amended demand and "to make whatever orders it deems appropriate and necessary to identify and clarify the issues to be considered by the Arbitrator in the arbitration proceedings." Id.

Plaintiff argues that the Court should instruct the Arbitrator to rule on the pending motion to dismiss in its entirety. Plaintiff contends that the new claims, which allege breach of contract and violation of the MMVFPA, are analogous to the claims the court has already referred to arbitration. With regard to the claims previously dismissed by this Court, plaintiff contends that they have been replead with additional factual allegations and that they now clearly state claims for relief. Plaintiff also maintains that the Court's prior dismissal is not binding on the Arbitrator because of the interlocutory nature of the ruling. Document 28.

Defendant contends that the tortious interference and third-party beneficiary claims are not arbitrable and that this Court's dismissal of those claims may not be collaterally attacked in the arbitration. Accordingly, defendant contends that the Court should instruct the arbitrator not to consider those claims. Defendant concedes that the breach of contract and statutory violation claims are subject to arbitration.

Thus, defendant maintains that the Court should instruct the arbitrator to rule on the motion to dismiss with respect to those claims. Finally, defendant asserts that the Court should instruct the Arbitrator not to rule on any additional claims unless they have been determined to be arbitrable by this Court. Defendant also requests reasonable attorneys, fees for the costs incurred in the arbitration up to this point. Document 29.

The Court concludes the Arbitrator should not consider either the tortious interference with business expectancy or contract claim or the third-party beneficiary claims in the amended demand (Counts II, III, IV). The reasoning underlying the Court's prior ruling that these claims do not fall within the scope of the arbitration clause applies to the amended claims. The claims do not arise from the franchise agreement executed by plaintiff and defendant and thus are not within the scope of the arbitration clause.

Moreover, before referring this matter for arbitration, the Court dismissed for failure to state a claim for relief the tortious interference with contract and breach of third-party beneficiary contract claims asserted by plaintiff in the initial complaint. Under the law of the case doctrine, when a Court issues a decision on a legal question, that decision generally governs the same issues in subsequent stages of the same case. See Little Earth of the United Tribes v. United States Dep' t of Housing & Urban Dev., 807 F.2d 1433, 1440-41 (8th Cir. 1986). This Court may reconsider the prior order, see Murr Plumbing, Inc. v. Scherer Bros. Financial Servs., 48 F. 3d 1066, 1070 (8th Cir. 1995), but the Arbitrator must adhere to the Court's rulings on legal issues. In any event, the claims alleged in the amended demand suffer from the same legal deficiencies as the claims asserted in the original complaint.

As for the new claims asserted in the amended demand, the Court agrees with the parties that these claims

arise from the same legal principles as the claims initially submitted to arbitration and should be considered by the Arbitrator. Thus, Counts VII and VIII of the amended demand are proper for arbitration, and the Arbitrator may rule on the motion to dismiss these claims or take any other appropriate action with respect to these claims. The Arbitrator should refuse to consider any additional claims until this Court has determined their arbitrability. See Houlihan v. Offerman & Co. Inc., 31 F.3d 692, 694-95 (8th Cir. 1994) (district court must determine whether dispute falls within scope of arbitration agreement before party may be compelled to arbitrate).

Accordingly,

IT IS HEREBY ORDERED that the plaintiff's Motion for instructions to the Arbitrator, is **GRANTED** as set forth below. [Doc. 28]

IT IS FURTHER ORDERED that the Arbitrator shall not consider Counts II, III, and IV of the amended demand.

IT IS FURTHER ORDERED that the Arbitrator shall consider Counts VII and VIII of the amended demand and may rule on the motion to dismiss those claims or take any other action he deems appropriate with respect to those claims.

IT IS FURTHER ORDERED that the Arbitrator shall not consider any new claims which plaintiff may assert prior to this Court's determination that the claims are arbitrable.

IT IS FURTHER ORDERED that defendant's request for attorneys' fees incurred up to this point in the arbitration proceedings **DENIED without prejudice**.

(Signature omitted in printing)

CHARLES A. SHAW
UNITED STATES DISTRICT JUDGE
Dated this 7th day of August, 1995.

United States District Court
Eastern District of Missouri
Eastern Division.

BOB SCHULTZ MOTORS, INC., Plaintiff,

v.

KAWASAKI MOTORS CORPORATION, U.S.A.,
Defendant.

No. 4:93-CV-807 CAS

ORDER

By leave of Court, and with the consent of Defendant, Plaintiff is hereby granted leave to file its Second Amended Complaint.

Further, consistent with the Court's prior Orders of August 7, 1995 and March 30, 1994, it is hereby ordered that:

1. Counts I, II, III, IV and V of the Second Amended Complaint are hereby dismissed and the Arbitrator referenced in the Order of August 7, 1995 shall not consider any of said Counts; and

2. Counts VI, VII, VIII and IX of the Second Amended Complaint are referred to the previous arbitrator to rule on Kawasaki's motion to dismiss said counts and to otherwise arbitrate those disputes.

3. The Court's previous ruling on the handling of this matter remains in effect.

SO ORDERED

(Signature omitted in printing)

CHARLES A. SHAW
UNITED STATES DISTRICT JUDGE

Dated this 30th day of January, 1996.

American Arbitration Association
Commercial Arbitration Tribunal

BOB SCHULTZ MOTORS, INC., Claimant

v.

KAWASAKI MOTORS CORPORATION, U.S.A.,
Respondent.

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FINAL ARBITRATION AWARD

I, THE UNDERSIGNED ARBITRATOR, having been designated in accordance with ¶ 32 of the Kawasaki Authorized Dealer Service and Sales Agreements between the parties ("the Agreements"), and having been duly sworn, and the issues of liability and damages having been bifurcated, and having heard the allegations and proofs of the parties concerning the issues of liability, and the proceedings having been declared closed and the issues of liability having been submitted for decision on April 7, 2000, and having made my Ruling on Liability Issues on May 4, 2000 in favor of respondent, and having determined that respondent is the prevailing party, and having heard the allegations and proofs of the parties concerning respondent's claim for costs and expenses, hereby make my FINAL AWARD OF ARBITRATOR, as follows:

1. Kawasaki Motors Corp., U.S.A. ("respondent") is not liable to Bob Schultz Motors, Inc. ("claimant") for damages ad claimant is not entitled to recover damages from respondent.

2. The Arbitrator's Statement of Reasons in Support of Ruling on Liability Issues made on May 4, 2000 was attached to his Ruling on Liability Issues and is incorporated herein by reference.

3. Respondent is the prevailing party in this proceeding; however, the arbitrator finds that the provision of ¶ 32 of the Agreement providing for the prevailing party to recovery from the nonprevailing party any costs and expenses of the arbitration including without limitation attorney's fees is unconscionable and shall not be enforced. The parties shall bear their own costs and attorneys' fees.

4. The Arbitrator's Statement of Reasons in Support of Ruling on Costs and Expenses is attached hereto and incorporated herein by reference.

5. The fees and expenses of the American Arbitration Association, totaling $21,246.50, shall be borne as incurred.

6. The Arbitrator's compensation and expenses, totaling $103,286.53, shall be borne as incurred

(Signature omitted in printing)
Richard P Byrne, Arbitrator
DATED: January 31, 2001

Statement of Reasons in Support of Ruling on Costs and Expenses

In his Ruling on Liability Issues made in this proceeding on May 4, 2000, the Arbitrator found that Kawasaki was the prevailing party in this proceeding and in accordance with ¶ 32 of the Dealer Sales and Service Agreement ("the franchise agreement") was entitled to recover from claimant all costs and expenses of the arbitration, including, without limitation, attorneys' fees. In making that finding, the Arbitrator was relying solely upon the language of ¶ 32 and had not considered any defenses that Schultz might raise concerning its enforceability.

Thereafter, Kawasaki submitted its request for costs and expenses and Schultz submitted its opposition. The amount requested was $1,760,438.63.

A hearing was held in St. Louis, MO on January 16 & 17, 2001 at which time evidence was presented and arguments were made. Kawasaki reduced the amount it was requesting to $1,725,923.63 at the hearing. Additional documentation was received from Kawasaki on January 20, 2001 which increased the amount Kawasaki was requesting by $46,891.60 to $1,772,815.23. The hearing was declared closed and the issue was submitted for decision on January 22, 2001.

At the hearing on costs and expenses, Schultz presented evidence and argued that ¶ 32 of the franchise agreement, particular the clause that requires the nonprevailing party to pay all of the costs and expenses of the arbitration, is unconscionable and should not be enforced and cited *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 6 P.3d 669 (2000) and other authorities in support of its position. Kawasaki argued that Judge Shaw had already determined that the arbitration provision was enforceable.

The Arbitrator finds that the part of ¶ 32 of the franchise agreement relating to the prevailing party being entitled to recover all costs and expenses of the arbitration is an unconscionable provision and should not be enforced. In arriving at his decision, the Arbitrator applied California law as required by ¶ 34 of the franchise agreement.

The Arbitrator hereby states the reasons for his decision on costs and expenses in summary form. This statement is not meant to be an exhaustive analysis of every factual or legal point raised by the parties. Its purpose is to provide the parties with a basic understanding of the reasons upon which the decision is based.

¶ 32 of the franchise agreement is as follows:

32. DISPUTE RESOLUTION.

All controversies, claims and disputes arising in connection with this Agreement, except an controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claims or disputes, except those expressly excluded above. Judgment upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against DISTRIBUTOR, or in any court which has

jurisdiction over DEALER, if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys' fees.

The Arbitrator has considered the arguments of counsel and finds that the Order made by Judge Shaw was limited to the issue of arbitrability and did not address that part of ¶ 32 relating to awarding costs and expenses to the prevailing party and did not apply California law in arriving at his decision and that the Arbitrator is free to decide whether the costs and expenses provision of the arbitration clause is unconscionable based upon California law and all of the evidence presented in this case.

Judge Shaw's ruling can best be understood in the context of what was presented to him for decision. Schultz had filed a five-count Petition against Kawasaki in the Circuit Court of St. Louis County, Missouri, in February, 1993. The first four counts alleged substantive claims. Count V was for declaratory relief and asked the Court to declare ¶ 32 to be unenforceable because it would require Schultz to resolve claims in arbitration proceedings rather than in the public court system. Schultz was objecting to arbitrating the case. In the alternative, Schultz asked the Court to at least declare ¶ 32 unenforceable to the extent it purported to require the holding of the arbitration proceedings in Los Angeles, California, because of undue hardship. Schultz alleged that the reasons that said provisions should be declared unenforceable were that the agreements were contracts of adhesion and that said provisions violated the public policy of the State of Missouri. No mention was made of the costs and expenses provision in ¶ 32.

Kawasaki removed the action to the federal court on diversity grounds and filed a motion to dismiss claimant's

complaint in the federal district court. The motion was briefed and argued before Judge Charles A Shaw, the judge assigned to the case ("Judge Shaw" and "the Court").

Kawasaki filed a motion to dismiss all counts and request the Court to refer any counts which were not dismissed to arbitration. In its opposition to referring any of the counts to arbitration, Schultz raised four defenses, *to wit*, that the agreements were obtained by economic duress, that the agreements were contracts of adhesion, that the contracts lacked mutuality of obligation, and that the arbitration clause violated Missouri public policy.

On March 30, 1994, the Court issued its Memorandum and Order ("Order") in which it dismissed two counts, rejected claimant's contentions that the arbitration clause was unenforceable, and referred the two remaining counts and Schultz' economic duress defense to arbitration. The economic duress claim was later abandoned by Schultz before it was heard by the Arbitrator.

In referring the two counts to arbitration, Judge Shaw found that the arbitration provision in the franchise agreements was covered by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("the FAA") and that the two counts which were not dismissed were disputes within the scope of the arbitration clause. In arriving at this conclusion, the Court stated that the FAA set out a liberal federal policy favoring arbitration agreements and that the effect of § 2 of the FAA was to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the FAA. (Order, p. 3)

The Court devoted a single paragraph to Shultz' claim that the franchise agreements were contracts of adhesion. The Court cited two federal cases in support of its conclusion, *to-wit*, *Webb v. R. Rowland d Co., Inc,* 800 F.2d 803, 807 (8th Cir. 1986) and *Surman v. Merrill Lynch Pierce, Fenner & Smith*, 733 F.2d 59, 61 n.2 (8th Cir. 1984).

Both cases involved the enforcement of arbitration agreements in cases brought by customers against their stock brokers. The issue presented in both cases was arbitrability. No California cases were cited.

It is clear that the Court's analysis was directed to deciding whether the provision requiring the parties to arbitrate their dispute should be enforced. The issue was arbitrability – whether the case should be heard in the federal court or referred to arbitration. The Court did not decide that the agreements were contracts of adhesion under California law. It did not make any decision concerning the last sentence of ¶ 32, which relates to the issue of awarding the costs and expenses of the arbitration to the prevailing party, or consider that provision in arriving at its decision. This provision was not addressed in any of the pleadings and was not even mentioned in the Order.

Judge Shaw cited footnote 2 of the *Surman* case, *supra*, in his Order for the proposition that there is nothing inherently unfair about arbitration clauses and that they are therefore valid and enforceable (Order, at p. 8). Footnote 2, in its entirety, reads as follows:

> "Appellees argue that the three brokerage agreements are contracts of adhesion and that the arbitration clauses are therefore unenforceable. When presented with a standardized contract of adhesion, a court may deny giving effect to an "unconscionable" clause therein. *See* 6A. Corbin, Contracts § 1376, at 20-22 (1962). Thus appellees' argument is directed at the over-reaching of the arbitration clause itself which is a matter for judicial determination. But see *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 637 F.2d 391, 398 (5th Cir. 1981) (investor's contentions of duress and unconscionability regarding standard brokerage agreements are to be decided by arbitrator not court). There is certainly nothing inherently

unfair about the arbitration clauses, and they are therefore valid and enforceable." (emphasis added)

The *Haydu* case was an action brought by customers against their broker in the federal court for the southern district of Florida alleging negligence, fraud and breach of fiduciary duties in the handling of their stock option accounts. The stock option agreements contained an arbitration clause. The case involved a number of complicated procedural issues with several unanswered questions and the circuit court remanded it to the district court with directions to address these issues. The Court stated, at p. 398:

> "Finally, we conclude that Haydu's contentions that the district court deprived her of due process are wholly without merit. Her claims regarding duress and unconscionability are one that, in the event of arbitration, would be decided by an arbitrator, not the district court, since they go to the formation of the entire contract rather than to the issue of misrepresentation in the signing of the arbitration agreement."

As noted above, Judge Shaw referred the economic duress claim but not th unconscionability claim to be decided by the Arbitrator. If *Haydu* had been applied, Schultz' unconscionability claim would have been referred to the Arbitration to conduct a hearing and make a decision. This is also consistent with the requirements of California Civil Code, § 1670.5(b), *infra*.

The Arbitrator has had the benefit of having been involved in almost every facet of this case from the time of his appointment in 1994, including many motions and discovery hearings, the fourteen day hearing in Los Angeles on the merits, and the two day hearing in St. Louis on costs and expenses. The Arbitrator is in the unique position of evaluating the true effect of the arbitration agreement upon

Schultz and whether the costs and expenses provision in the arbitration agreement is unconscionable and enforceable.

It is the opinion of the Arbitrator that whether the costs and expenses provision of ¶ 32 is unconscionable or not is an open issue to be decided by the Arbitrator based upon California law and the evidence presented in the case.

In 1979, California enacted Civil Code § 1670.5, which codified the principle that a court can refuse to enforce an unconscionable provision in a contract. § 1670.5(a) states:

> "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."

Civil Code § 1670.5(b) states:

> "When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination."

The *Armendariz* case, *supra*, cited by Schultz and discussed at length in its Supplemental Memorandum in Opposition to Requests for Alleged Fees, Costs, and Expenses (Ex. 3) is a wrongful termination employment case recently decided by the California Supreme Court. The case was brought under the California Fair Employment and Housing Act. Plaintiffs alleged that they filled out and signed employment application forms, which included an arbitration clause pertaining to any future claim of wrongful

termination, and separate employment arbitration agreements, containing the same arbitration clause. Some of the decision relates to an examination of the minimum requirements for the arbitration of unwaivable statutory rights, which are not involved in this case. A significant part of the decision, however, discusses objections to arbitration which apply more generally to any type of arbitration imposed by one party upon another, which fall within the term "unconscionability." The Court applied these general principles of contract law in arriving at its conclusion that the agreement contained unconscionable provisions, that the unconscionable provisions could not be severed from the provisions that were not unconscionable, and that the entire arbitration clause was unenforceable by reason thereof.

In addition to *Armendariz*, the Arbitrator has reviewed and relied upon *Graham v. Scissor-Tail*, 28 Ca.3d 807, 623 P.2d 165 (1981), *Perdue v. Crocker Nat. Bank*, 38 Cal.3d 913 (1985), *Patterson v. ITT Consumer Financial Corp.*, 14 Cal. App. 4th 1659 (1993) and *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473 (1982) in arriving at his decision.

In *Graham v. Scissor-Tail, Inc.*, *supra*, 28 Cal.3d 807, the Court stated:

> "To describe a contract as adhesive in character is not to indicate its legal effect. A contract of adhesion is fully enforceable according to its terms unless certain other factors are present which, under established legal rules - legislative or judicial - operate to render it otherwise." (p. 819-20.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering'

> party will not be enforced against him. [citations.] The second - a principle of equity applicable to all contracts generally - is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable'" (p. 820.)

Patterson v. ITT Consumer Financial Corp., *supra*, discussed the approach taken by the Supreme Court in *Scissor-Tail* and another approach taken in *A & M Produce Co.*, *supra*.

> "The alternative analytical model was set out in *A & M Produce Co. v. FMC Corp.* . . . It sought to define what rendered a contract or a contractual provision unconscionable and hence unenforceable under Civil Code section 1670.5. . . . *A & M* concluded that unconscionability has a procedural and a substantive component. . . . The procedural component focuses on the factors of oppression and surprise. . . . The substantive component of unconscionability looks to whether the contract allocates the risks of the bargain in an objectively unreasonable or unexpected manner. . . . To be unenforceable there must be both substantive and procedural unconscionability, though there may be an inverse relation between the two elements." (p. 1664.)

Evidence was introduced during the arbitration hearing and the hearing on costs and expenses which related to the circumstances surrounding the execution of the franchise agreements.

William C. Wefel acquired a Kawasaki dealership in St. John, Missouri from Bob Schultz Motors, Inc. ("Schultz") in 1975 and a second Kawasaki dealership in St. Charles, Missouri in 1981. At all relevant times,

Mr. Wefel was the president and sole shareholder of Schultz and the operator of both dealerships.

Mr. Wefel signed an identical franchise agreement for each location on behalf of Schultz. These were renewed each year by Schultz and Kawasaki until 1988. These were standardized agreements which did not contain an arbitration clause and Schultz and Kawasaki's other franchisees had full access to a court for the adjudication of any disputes arising under the contracts.

In 1987, Kawasaki presented Schultz and other franchisees with agreements which were to run for three years instead of one. These agreements were standardized documents drafted by Kawasaki for more than 900 franchisees in the United States. For the first time they contained an arbitration clause. Schultz was not afforded an opportunity to negotiate with Kawasaki concerning any of the terms of these agreements. Mr. Wefel was told that he had to sign the agreements if he wanted to keep the Kawasaki franchises. It was, a "take it or leave it" proposition. This is not disputed by Kawasaki.

By the time the revised franchise agreements were presented to Schultz in 1987, Mr. Wefel had already invested hundreds of thousands of dollars and more than a decade of time and effort in selling Kawasaki products and had developed the two locations into substantial and successful Kawasaki franchises. He didn't want the arbitration clause and did not voluntarily agree to it. However, he was presented with the decision to either sign the agreements "as is" or forfeit the Kawasaki franchises and lose his investment. He felt he had no choice but to sign the agreements and he did.

The same thing occurred in 1990 when he was presented with the standardized agreements which are involved in this case.

Mr. Wefel's testimony was supported by that of Donald C. Pruitt, who testified at the arbitration and at the hearing on costs and expenses. Also, Mr. Pruitt's affidavit was received in evidence at the hearing on costs and expenses (Ex. 3). Mr. Pruitt was employed by Kawasaki from 1981 to 1993. Before that time he worked in a multi-line dealership which sold motorcycles, all-terrain vehicles, and power products. As a result of this experience he became very knowledgeable about the industry and the operation of dealerships. During his employment with Kawasaki he held a number of different positions, including Director of National Sales. In his various capacities, he became knowledgeable about the operations and financial condition of the members of the Kawasaki dealer networks. As part of his duties with Kawasaki, he visited and became familiar with a very high percentage of the Kawasaki dealerships across the United States.

Mr. Pruitt stated that it was Kawasaki's official policy not to negotiate the terms of its agreements with its dealers. Under this policy, dealers who wished to operate on terms other than those put forward in Kawasaki's agreements were not permitted to continue as Kawasaki dealers. Kawasaki employees were instructed that, if a dealer requested a change in the terms, the employee was to apologize but to insist that the terms were not open to discussion or debate.

Mr. Pruitt also stated that he was not aware of any Kawasaki dealer other than Schultz who had brought a claim against Kawasaki and that he estimated that more than 95% of the dealers lacked the financial ability to proceed with such a claim because of Kawasaki's ability to impose arbitration and make the procedure prohibitively expensive.

The Missouri Motor Vehicle Franchise Practices Act governs the relationship between franchisors (like Kawasaki) and franchisees (like Schultz). Unlawful practices include

coercing a franchisee "to enter into any agreement with such motor vehicle franchisor . . . by threatening to cancel any franchise or any contractual agreement existing between such motor vehicle franchisor and motor vehicle franchisee." Mo. Rev. Stat. § 407.825(4). Kawasaki's institutional policy of imposing its contractual terms on dealers with the threat of losing the dealership is just such an unlawful practice.

The arbitration clause of the franchise agreement is clearly a contract of adhesion under California law. It was imposed upon Schultz (a small, local business) by Kawasaki (a large, national and international corporation with over 950 dealerships in the United States) as a condition of Schultz' retaining its Kawasaki dealerships. It was presented on a "take it or leave it" basis. There was no opportunity to negotiate. The economic pressure asserted on Schultz by Kawasaki was particularly acute. Schultz either signed the franchise agreement with the arbitration provision or lost the Kawasaki franchises.

The Arbitrator also finds that the arbitration agreements were unconscionable at the time they were made and refuses to enforce provision in ¶ 32 which gives the prevailing party the right to recover all costs and expenses of the arbitration, including without limitation, attorneys' fees.

As stated in *Armendariz*, *supra*, at p. 115:

> "While arbitration may have its advantages in terms of greater expedition, informality, and lower cost, it also has, from the employee's point of view, potential disadvantages: waiver of a right to a jury trial, limited discovery, and limited judicial review. . . . Arbitration is favored in this state as a voluntary means of resolving disputes, and this voluntariness has been its bedrock justification. As we stated recently: ' [P]olicies favoring the efficiency of private arbitration as a means of dispute resolution must sometimes yield to its fundamentally

contractual nature, and to the attendant requirement that arbitration shall proceed as the parties themselves have agreed.' (*Vandenberg v. Superior Court*, *supra*, 21 Cal. 4th at p. 831, italics omitted.) Given the lack of choice and the potential disadvantages that even a fair arbitration system can harbor for employees, we must be particularly attuned to claims that employers with superior bargaining power have imposed one-sided, substantively unconscionable terms as part of an arbitration agreement. 'Private arbitration may resolve disputes faster and cheaper than judicial proceedings. Private arbitration, however, may also become an instrument of injustice imposed on a 'take it or leave it' basis. The courts must distinguish the former from the latter, to ensure that private arbitration systems resolve disputes not only with speed and economy but also with fairness.' (*Engala*, *supra*, 15 Cal. 4th at p. 989 (conc. opn. of Kennard, J.).)"

While *Armendariz* is an employment case, the language quoted above applied general contract principles and applies to the franchise agreements involved herein.

It appears to the Arbitrator that procedural and substantive unconscionability are both present in this case. The clause, when considered as a whole, is oppressive due to the unequal bargaining power of the parties and the greater advantages entering to the benefit of Kawasaki, who can well afford to pursue claims brought by franchisees with great vigor. The clause was overly harsh in the burdens it imposed upon franchisees who were not in a position to object and who could suffer great consequences if unsuccessful.

A number of factors lead the Arbitrator to the conclusion that the arbitration agreement is unconscionable.

First, the agreement lacks mutuality in that it gives Kawasaki, but not a franchisee, the right to go to court in cases involving amounts due and unpaid to Kawasaki, the retaking of possession of any product, and third party personal injury claims. These claims are not involved herein and can be severed from the rest of the arbitration provision.

Second, the agreement requires the arbitration to take place in Los Angeles even though there is no reasonable justification or legitimate commercial purpose to be served by holding it there. The fact that Kawasaki's main office is located in Orange County would normally have no bearing upon and little relationship to cases which arise elsewhere and which are brought against Kawasaki. It appears that this requirement serves no purpose other than to make it more difficult and expensive for the franchisee to prosecute his claim.

Third, the agreement provides that the prevailing party is entitled to recover all costs and expenses of the arbitration, including attorneys' fees. This would appear to be an evenhanded provision at first blush but, upon further analysis, it is not. This argument ignores the great risk a franchisee takes if it attempts to assert its rights against Kawasaki. It cannot be disputed that the resources available to Kawasaki are substantial when compared to those available to the average Kawasaki franchisee. (See testimony of Donald Pruitt, *supra*.) Kawasaki can easily absorb the costs and expenses if it loses a case and has to pay the franchisees costs and expenses. On the other hand, a franchisee runs the risk of substantial loss and even bankruptcy if it brings an action against Kawasaki and loses. The franchisee not only pays his own costs and expenses incurred in bringing the case to hearing and the additional costs and expenses of trying the case in Los Angeles but runs the risk of paying Kawasaki's costs and expenses, including the costs and expenses incurred by Kawasaki's St. Louis

counsel for trying the case in Los Angeles, if he loses. Also, the nonprevailing party is required to pay *all* costs and expenses of the arbitration. The fees that are to be paid are not limited to *reasonable* fees. Nor are the costs and expenses limited to the costs and expanses that the prevailing party would be entitled to recover if the case had been heard in the public system. Under California law, the prevailing party in a proceeding filed in the Superior Court would not be entitled to recover much of what has been claimed by Kawasaki. See Code of Civil Procedure, § 1033.5. (*e.g.*, Kawasaki claims $371,184.21 for expert costs and expenses. These would not be allowed under California law. Code of Civil Procedure, § 1033.5(b)(l).)

This is not an arbitration agreement that has a "chilling effect" upon the franchisee; this is an agreement that puts the franchisee out in the freezing cold.

This case involved a dispute that could have more easily been heard in St. Louis. Schultz was located there. Counsel for both Schultz and Kawasaki were located there. Most of the witnesses, except some Kawasaki personnel headquartered in Orange County, were located there. The other witnesses who were not in the St. Louis area had to be brought in from elsewhere. It would have made little difference to bring them in to St. Louis rather than Los Angeles. A local arbitrator could have been appointed. However, as it turned out, the Arbitrator who was appointed volunteered to come to St. Louis to hear the case. This was resisted by Kawasaki and, in the absence of agreement, the American Arbitration Association followed the language of ¶ 32 and refused to change the venue of the hearing. The hearing was conducted over a period of three weeks (14 hearing days) in Los Angeles in March and April, 2000. As a result, considerable additional costs and expenses were incurred by Schultz in order to present its case. Further, substantial costs were incurred by Kawasaki that would have

been unnecessary if the case had been heard in St. Louis. Schultz is now being asked to pay these expenses.

The Arbitrator believes that ¶ 32 is unconscionable and should not have been enforced. However, the Court decided that the case should be referred to arbitration and declined to change the venue from Los Angeles to St. Louis. It's too late to alter that result at this time. However, the Court did not rule upon that part of ¶ 32 that requires the nonprevailing party to pay all of the costs and expenses of the prevailing party. The issue of the enforceability of that clause is properly before the Arbitrator at this time.

Kawasaki's overall claim of $1,772,815.23 may not be an unreasonable cost for Kawasaki to pay for its defense of the Schultz claim. However, it is an unreasonable cost to impose upon Schultz and is dramatic evidence of why the Arbitrator believes that the provision in the arbitration agreement that purports to require Schultz to pay Kawasaki's costs and expenses is unconscionable.

Accordingly, the Arbitrator finds that the clause in ¶ 32 of the franchise agreement granting the prevailing party the right to recover all costs and expenses of the arbitration including without limitation, attorneys' fees, was unconscionable at the time it was made and should not be enforced.

The effect of this ruling is to put the parties in the position they would be in if the clause did not exist. Under California law, the prevailing party is not entitled to recover attorneys' fees in the absence of a contractual provision unless authorized by statute. There is no such statute involved in this case. Further, in arbitration proceedings, where there is no contractual provision to the contrary, each side is required to bear its own costs and expenses. Code of Civil Procedure § 1284.2.

The Arbitrator, in the exercise of his discretion under the applicable rules of the American Arbitration Association, finds that each side should equally bear the fees and expenses of the AAA and the compensation and expenses of the Arbitrator.

(Signature Omitted in Printing)

United States District Court
Eastern District of Missouri
Eastern Division.

BOB SCHULTZ MOTORS, INC., Plaintiff,

v.

KAWASAKI MOTORS CORPORATION, U.S.A.,
Defendant.

No. 4:93-CV-807 CAS

MEMORANDUM AND ORDER

This reopened diversity matter is before the Court on defendant Kawasaki Motors Corp., U.S.A.'s Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorney's Fees, Costs and Litigation Expenses, and plaintiff Bob Schultz Motors, Inc.'s ("Schultz Motors") Alternative Motion to Vacate the Arbitrator's Final Award of Arbitration. These motions are filed pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16.

Background.

In February 1993, Schultz Motors filed a five-count petition against Kawasaki in state court asserting claims for breach of contract, tortious inference with contractual relationship, breach of third party beneficiary contract, unlawful conduct under the Missouri Motor Vehicle Franchise Practices Act, and for declaratory relief. The claim for declaratory relief sought, inter alia a declaration that paragraph 32 (the "arbitration provision") of the Dealer Sales and Service Agreement (the "Franchise Agreement") between Kawasaki and Schultz Motors was unenforceable in its entirety because it was a contract of adhesion, was unconscionable, and violated Missouri public policy.

The arbitration provision states:

32. DISPUTE RESOLUTION

All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR (Kawasaki], relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the provisions of this Section 32. Such arbitration shall be conducted in Los Angeles, California, in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claim or disputes, except those expressly excluded above. Judgment (sic] upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against DISTRIBUTOR, or in any court which has jurisdiction over DEALER (Schultz Motors], if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys' fees.

On April 1, 1993, Kawasaki removed the case to this Court and it was assigned to the Honorable Carol E. Jackson. Kawasaki moved to dismiss each count of the petition asserting, inter alia, that the arbitration provision was not a contract of adhesion, was not unconscionable, and was consistent with Missouri and federal policy favoring arbitration. The case was transferred to the undersigned on January 11, 1994.

On March 30, 1994, the Court issued a memorandum and order which, inter alia dismissed Schultz Motors's tortious interference and third-party beneficiary claims, held that the arbitration provision was not unconscionable, and held that the issue of whether the arbitration agreement was procured by duress was a matter for the arbitrator, as the issue went to the "formation of the entire franchise agreement." In compliance with the Court's order, Schultz Motors filed a demand for arbitration. Schultz Motors subsequently abandoned its argument based on economic duress before that claim could be addressed by the arbitrator.

In its Amended Demand for Arbitration, Schultz Motors reasserted its tortious interference and third-party beneficiary claims and added new claims. The arbitrator stayed further proceedings and requested the Court to consider and clarify whether Schultz Motors could pursue these claims in the arbitration. On April 26, 1995, Schultz Motors filed a Motion for Instructions to the Arbitrator. On August 7, 1995, the Court issued a memorandum and order which dismissed the tortious interference and third-party beneficiary claims asserted by Schultz Motors in the Amended Demand, but permitted it to pursue new Counts VII and VIII. In the order of August 7, 1995, the Court stated, inter alia, "[W]hen a Court issues a decision on a legal question, that decision generally governs the same issues in subsequent stages of the same case," and "the Arbitrator must adhere to the Court's rulings on legal issues."

The arbitration proceeded in Los Angeles, California almost five years later in March 2000, and was heard for three weeks. On May 4, 2000, the arbitrator issued his Ruling on Liability Issues, which held that Kawasaki was not liable to Schultz Motors for any damages. The arbitrator further held that Kawasaki was the prevailing party in the arbitration and, pursuant to Paragraph 32 of the Franchise

Agreement, was "entitled to recover from (Schultz Motors) all costs and expenses of the arbitration, including, without limitation, attorneys' fees."

The hearing on the amount of Kawasaki's expenses, including attorneys' fees, was held in St. Louis, Missouri, on January 16 and 17, 2001. Kawasaki presented evidence that its attorney's fees and litigation expenses for the seven-year pendency of the matter totaled $1,722,815.23.

The arbitrator issued a Final Award of Arbitrator on January 31, 2001, which incorporated by reference the Ruling on Liability Issues. The Final Award denied Kawasaki's request for attorney's fees and costs on the basis that the provision of paragraph 32 of the Franchise Agreement which gives the prevailing party the right to recover from the nonprevailing party all costs and expenses of the arbitration, including attorney's fees, was unconscionable under applicable California law and would not be enforced.[6] The arbitrator concluded that the portion of the March 30, 1994 memorandum and order which found the arbitration provision not unconscionable was limited to the issue of arbitrability, did not address the portion of paragraph 32 relating to awarding fees and expenses to the prevailing party, and was not based on California law. The arbitrator's Final Award explained why he believed he had the authority to find a portion of paragraph 32 unconscionable:

It is clear that the Court's analysis [in the March 30,1994 order] was directed to deciding whether the

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[6] Paragraph 34 of Franchise Agreement provides in pertinent part: "This agreement and the rights and obligations arising thereunder shall be governed by and construed according to the laws of the State of California."

provision requiring the parties to arbitrate their dispute should be enforced. The issue was arbitrability - whether the case should be heard in federal court or referred to arbitration. The court did not decide that the agreements were contracts of adhesion under California law. It did not make any decision concerning the last sentence of 132, which relates to the issue of awarding the costs and expenses of the arbitration to the prevailing party, or consider that provision in arriving at its decision. This provision was not addressed in any of the pleadings and was not even mentioned in the Order.

Def's Ex. L, Statement of Reasons in Support of Ruling on Costs and Expenses, at 3.

On February 16, 2001, the parties filed a joint motion to reopen the case. In April 2001, Kawasaki filed its motion to confirm in part and vacate in part the arbitrator's award. Schultz Motors responded in opposition and filed its alternative motion to vacate the final award.

Parties' Arguments.

Kawasaki seeks to confirm the arbitrator's liability ruling under 9 U.S.C. § 9, and to vacate or modify the portion of the arbitration award denying it attorney's fees and costs, pursuant to 9 U.S.C. § § 10(a)(4) or 11(b). Kawasaki asserts that the attorney's fee ruling must be vacated because the arbitrator exceeded his powers in holding the arbitration provision unenforceable, 9 U.S.C. § 10(a)(4), and/or because he ruled on a matter not submitted, see 9 U.S.C. § 11(b). Kawasaki also argues that the arbitrator violated the law of the case doctrine by disregarding this Court's prior ruling that the arbitration provision was not unconscionable, and by ignoring the Court's admonition that the arbitrator "must adhere to the Court's ruling on legal issues."

Kawasaki states that the strong public policy favoring arbitration provisions further dictates that the arbitrator's ruling as to fees and costs must be vacated and/or modified, as fee shifting provisions such as the one in the Franchise Agreement are an integral part of commercial arbitration agreements, and there is no incentive for companies to expend significant sums on arbitration costs if they are to be subjected to such an unjust result. Kawasaki notes that Schultz Motors only raised the unconscionability argument after it lost the liability case, and prayed for attorney's fees, costs and expenses in its Demand for Arbitration. Kawasaki states that Schultz Motors would undoubtedly not have argued the provision was unconscionable had it won the liability ruling.

In response, Schultz Motors states that as a matter of law the Court cannot confirm one portion of the arbitrator's award while vacating another, based on Eighth Circuit precedent interpreting the FAA. Schultz Motors states that the Court must either confirm the award in its entirety or vacate the award in its entirety. Schultz Motors also contends that Kawasaki has failed to present sufficient evidence that this case falls within the narrow exceptions for vacating the award under Section 10 of the FAA, or modifying it under Section 11. Schultz Motors filed its Alternative Motion to Vacate the Arbitrator's Final Award of Arbitration, in which it moves the Court to vacate the entire award. including liability findings, if the Court believes the arbitrator's ruling on attorney's fees exceeded his powers.

Discussion.

Review of a commercial arbitration award is governed by the FAA. The Eighth Circuit has often stated that "judicial review of an arbitration award is extremely limited." Val-u Constr. Co. of S. Dak. v. Rosebud Sioux Tribe, 146 F.3d 573, 578 (8th Cir. 1998). The Supreme Court of the United States has observed that courts will set

aside arbitrator's decisions "only in very unusual circumstances." First Options of Chicago. Inc. v. Kaplan, 514 U.S. 938, 942 (1995). "Arbitration awards should be construed, whenever possible, so as to uphold their validity" Delta Mine Holding Co. v. AFC Coal Properties. Inc.. 280 F.3d 815, 923 (8th Cir. 2001). Courts do not review the merits of the arbitration award, and where the arbitrator is even arguably construing or applying the contract and acting within his authority, a court cannot overturn the decision even if it is convinced that the arbitrator committed serious error. See Osceola County, Rural Water Sys.. Inc. v. Subsurfco. Inc.. 914 F.2d 1072, 1075 (8th Cir. 1990) (quoting United Paperworkers Int'l Union. AFL-CIO v. Misco. Inc., 484 U.S. 29, 38 (1987) (collective bargaining agreement case)).

The FAA lists only four narrow bases for vacating an arbitration award: (1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators; (3) where the arbitrators were guilty of misconduct in refusing to hear evidence material to the controversy, or of any other misbehavior, or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made. 9 U.S.C. § 10(a).

In addition to the statutory grounds for vacatur, the Eighth Circuit has recognized two non statutory bases for vacating an arbitration award: where the award "is completely irrational or evidences a manifest disregard for the law." Hoffman v. Cargill Inc., 236 F.3d 458, 461 (8th Cir. 2001) (quoting Val-U Constr. Co., 146 F.3d at 578) (internal quotation marks and citations omitted)). "These extra-statutory standards are extremely narrow: An arbitration decision may only be said to be irrational where it fails to draw its essence from the agreement, and an

arbitration decision only manifests disregard for the law where the arbitrators clearly identify the applicable, governing law and then proceed to ignore it." Hoffman 236 F.3d at 461-62 (citation omitted). A court "may not set aside an award simply because [it] might have interpreted the agreement differently or because the arbitrators erred in interpreting the law or in determining the facts." Id. (internal quotations marks and citation omitted). "Rather, the contract must not be susceptible of the arbitrator's interpretation." Id. (internal quotation marks and citation omitted).

Section 11 of the FAA permits a court to modify or correct an arbitration award "to effect the intent thereof and promote justice between the parties," 9 U.S.C. § 11, in the following circumstances only:

> (1) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (2) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (3) Where the award is imperfect in matter of form not affecting the merits of the controversy.

UHC Mgmt. Co., Inc. v. Computer Sciences Corp., 148 F.3d 992, 996 (8th Cir. 1998) (quoting 9 U.S.C. § 11(a)-(c)).

As previously stated, Kawasaki seeks to confirm the arbitrator's ruling as to liability. Kawasaki's motion to vacate and/or to modify the portion of the award denying it attorney's fees is based on the premise that the Court previously determined the entire arbitration provision was enforceable and not unconscionable in its order of March 30, 1994, and therefore the arbitrator necessarily exceeded his powers, 9 U.S.C. § 10(aX4), or awarded upon a matter not submitted to him, 9 U.S.C. § 11(b), in deciding that the

attorney's fee portion of the arbitration provision was unconscionable and declining to enforce it.[7]

Schultz Motors argues strenuously that an indivisible arbitration award may not be confirmed in part and vacated in part, and therefore the Court cannot do what Kawasaki is requesting. In support, Schultz Motors cites Legion Insurance Company v. VCW. Inc., 198 F.2d 718, 721 (8th Cir. 1999) (district court erred when it used Section 10 of the FAA to vacate in part and confirm in part arbitration panel's first order, where panel specifically indicated its award was indivisible; indivisible award had to be vacated or confirmed in its entirety), and UHC Management, 148 F.3d at 998 (party's request to have arbitration award selectively modified and then confirmed was governed by section 11 of the FAA; Eighth Circuit concluded an award could not be selectively modified unless one of the circumstances detailed in section 11 applied).

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[7] In its reply memorandum [Doc. 55], in response to an argument by Schultz Motors, Kawasaki appears to challenge the merits of the arbitrator's decision that the attorney's fee portion of the arbitration provision was unconscionable under California law. The Court may not address the merits of the award. Osceola County Rural Water Sys.. Inc. v. Subsurfco. Inc., 914 F.2d 1072, 1075 (8th Cir. 1990).

The Court does not interpret Kawasaki's reply memorandum as asserting the non-statutory bases for vacatur that the arbitrator's decision either fails to draw its essence from the Franchise Agreement or manifests an evident disregard for the law. Rather, Kawasaki states that when California law is examined, it provides further evidence for its contention that the arbitrator exceeded his powers and awarded upon an issue not submitted See Kawasaki's Resp. in Opp. at 11-12.

Kawasaki responds that both Legion Insurance and UHC Management are distinguishable from the instant case and do not preclude the dual relief it seeks. Kawasaki asserts that the arbitrator here did not specifically state that the award was indivisible, as did the panel in Legion Insurance, but rather issued two separate and divisible orders which may be confirmed and vacated separately under sections 9 and 10 of the FAA. Kawasaki asserts that UHC Management does not apply because in that case a party sought modification of the award on the basis that it did not comport with controlling Minnesota law, and the Eighth Circuit's ruling was based on its conclusion that failure to comport with controlling law was not one of the statutory grounds for modification listed in section 11. Kawasaki states it is seeking modification on the statutory ground that the arbitrator awarded upon an issue not submitted to him, see 9 U.S.C. § 11(b), when he ruled that the attorney's fee portion of the arbitration provision was unenforceable.

Schultz Motors also asserts that the Court did not hold in the order of March 30, 1994, that all portions of paragraph 32 of the Franchise Agreement were valid, binding, enforceable and not unconscionable. Rather, Schultz Motors asserts the Court's order focused on whether the provision requiring the parties to arbitrate their dispute should be enforced and, as expressly recognized by the arbitrator, specifically held only that the first sentence of paragraph 32 compelling arbitration was enforceable. Therefore, Schultz Motors contends, the arbitrator acted within the scope of his authority in denying Kawasaki's request for attorney's fees.

It is unclear whether the dual relief Kawasaki seeks could be granted under section 10 in the circumstances of this case. The express holding of Legion Insurance does not bar dual relief hero, as the arbitrator in this case did not designate the liability and attorney's fee rulings as

"indivisible." The Eighth Circuit has noted that its "precedents are somewhat unclear as to whether a district court may ever partially vacate an award using the standards of section 10," comparing Centralab. Inc. v. Local No. 816. Int'l Union of Elec., Radio and Machine Workers, 827 F.2d 1210 (8th Cir. 1987) (upholding district court decision using section 10 to vacate in part and confirm in part an arbitration award), with UHC Management, 148 F.3d 992 (holding that section 11 applies when a litigant seeks to have part of an arbitration award nullified and part confirmed). Legion Insurance, 198 F.3d at 721 n.5. The Eighth Circuit concluded in Legion Insurance that because the arbitration panel was explicit in its intent to make an indivisible award, it need not decide whether an award could be partially vacated under section 10.[8]

This Court similarly does not need to decide the issue. Rather, it concludes that the arbitration award should be confirmed in its entirety, as the arbitrator did not exceed his powers or award on a matter not submitted to him. The arbitrator correctly interpreted this Court's order of March 30, 1994 as addressing only the issue of arbitrability, ice, whether the arbitration provision between the parties should be enforced to require their dispute to be arbitrated. The Court did not address the attorney's fee provision, which

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[8] The authors of a treatise on the FAA observe that while partial vacation is available in arbitration proceedings under § 301 of the Labor Management Relations Act, they found no cases under the FAA which permit partial vacation. See I. MacNeil, et al., IV Federal Arbitration Law, § 41.3.1., 41:10 n.6 (1994). While the authors apparently overlooked the Eighth Circuit's Centralab decision, the seeming absence of other precedent to support partial vacation under section 10 of the FAA does not augur well for Kawasaki's position.

was not mentioned in any of the parties' pleadings at the time.

Given the arbitrator's power to interpret the Franchise Agreement, to find facts, to interpret and apply the law, and to make mistakes in so doing, the Court finds the arbitrator neither exceeded his powers nor awarded on a matter not submitted to him in determining that the attorney's fees portion of the arbitration provision was unconscionable under applicable California law. Cf. Remmey v. Painewebber. Inc., 32 F.3d 143, 146 (4th Cir. 1994) (courts' role in reviewing arbitral awards is "limited to determining whether the arbitrators did the job they were told to do--not whether they did it well, or correctly, or reasonably, but simply whether they did it.") (internal quotation and citations omitted), cert. denied 513 U.S. 1112 (1995). Accordingly, the Court concludes Kawasaki has not set forth a basis to vacate the award under section 10(a)(4) of the FAA, or to modify it under section 11(b).

Conclusion.

For the foregoing reasons, the Court concludes that the arbitrator's award should be confirmed. As a result, Kawasaki's Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorney's Fees, Costs and Litigation Expenses should be granted in part and denied in part, and plaintiff Bob Schultz Motors, Inc.'s Alternative Motion to Vacate the Arbitrator's Final Award of Arbitration should be denied as moot.

Accordingly,

IT IS HEREBY ORDERED that plaintiff Kawasaki Motors Corporation, U.S.A.'s Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorney's Fees, Costs and Litigation Expenses is GRANTED to the

extent the arbitration award will be confirmed, and DENIED to the extent Kawasaki seeks to vacate and/or modify the arbitration award as it pertains to attorney's fees. (Doc. 47-1, 47-2]

IT IS FURTHER ORDERED that defendant Bob Schultz Motors, Inc.'s Alternative Motion to Vacate the Arbitrator's Final Award of Arbitration is **DENIED** as moot. [Doc. 50]

A separate judgment will accompany this memorandum and order.

(Signature omitted in printing)
Charles A. Shaw
United States District Judge
Dated this 26th day of March, 2002.

United States Court of Appeals,
Eighth Circuit.

BOB SCHULTZ MOTORS, INC., a Missouri corporation,
Appellee,

v.

KAWASAKI MOTORS CORPORATION, U.S.A., a
Delaware corporation, Appellant.

No. 02-2323.

Appeal from the United States District Court
for the Eastern District of Missouri

ORDER DENYING PETITION FOR REHEARING AND FOR REHEARING EN BANC

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

(5128-010199)

August 13, 2003

Order Entered at the Direction of the Court:
(Signature omitted in printing)
Clerk U.S. Court of Appeals, Eighth Circuit

UNITED STATES CODE
TITLE 9. ARBITRATION

CHAPTER 1--GENERAL PROVISIONS

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

CREDIT(S) (July 30, 1947, c. 392, 61 Stat. 670.)

UNITED STATES CODE
TITLE 9. ARBITRATION
CHAPTER 1--GENERAL PROVISIONS

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall

make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

CREDIT(S) (July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233.)

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1--GENERAL PROVISIONS

§ 10. Same; vacation; grounds; rehearing

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration--

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

[**(5)** Redesignated (b)]

(b) If an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.

(c) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.

CREDIT(S)
(July 30, 1947, c. 392, 61 Stat. 672; Nov. 15, 1990, Pub.L. 101-552, § 5, 104 Stat. 2745; Aug. 26, 1992, Pub.L. 102-354, § 5(b)(4), 106 Stat. 946; May 7, 2002, Pub.L. 107-169, § 1, 116 Stat. 132.)

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1--GENERAL PROVISIONS

§ 11. Same; modification or correction; grounds; order

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration--

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

CREDIT(S)
(July 30, 1947, c. 392, 61 Stat. 673.)

No. 03-704

Supreme Court, U.S.
FILED
DEC 15 2003
OFFICE OF THE CLERK

In The

Supreme Court of the United States

KAWASAKI MOTORS CORP., U.S.A.,

Petitioner,

v.

BOB SCHULTZ MOTORS, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the United States Court of Appeals for the Eighth Circuit properly affirmed the district court's confirmation of an arbitration award under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*, where the arbitrator did not exceed his authority, did not rule on any issues that were not submitted to him, and the arbitrator's final award was neither irrational nor evidenced a manifest disregard for the law.

CORPORATE DISCLOSURE STATEMENT

The respondent is Bob Schultz Motors, Inc., a Missouri corporation that has no parent corporation. Its stock is not publicly traded, and no publicly traded company owns ten percent or more of its stock.

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Supreme Court Rule 10 1

JURISDICTIONAL STATEMENT

The respondent agrees with the petitioner that jurisdiction in this Court could be founded on 28 U.S.C. § 1254 if the appropriate facts and circumstances were present. This case, however, presents none of the compelling circumstances that could warrant a writ of certiorari as required by this Court's Rule 10. Therefore, the Court should exercise its discretion to deny the relief requested by the petitioner.

STATEMENT OF THE CASE

Kawasaki Motors Corp., U.S.A., continues to seek relief from the district court's Judgment Confirming Arbitration Award. The district court submitted the claims of Bob Schultz Motors, Inc., to arbitration on Kawasaki's strenuous insistence that the dealership agreements between Kawasaki and Schultz required arbitration of those claims. The district court granted Kawasaki all the relief it sought in connection with the request to compel arbitration, and Kawasaki has never appealed from that ruling.

The arbitration proceeding was bifurcated into a liability portion and a damages portion. The arbitrator found the liability issues in Kawasaki's favor. Kawasaki then presented to the arbitrator a request for an award of costs and expenses, including attorney fees. The parties submitted memoranda on the issue, and the arbitrator conducted a two-day hearing at which he received extensive evidence. Both parties fully participated in this hearing and submitted the issues to the arbitrator. After hearing the evidence, the arbitrator issued his Final

Award of Arbitrator, in which he found that the clause in the parties' arbitration agreement providing for the "prevailing party" to obtain all costs and expenses was unconscionable and unenforceable.

Kawasaki moved the district court to confirm the portion of the arbitration award favorable to Kawasaki and vacate the unfavorable portion. The basis of Kawasaki's motion to confirm and vacate was that the arbitrator purportedly exceeded his authority in deciding issues that the district court had not submitted to him, and in disregarding or misinterpreting the district court's prior ruling on the arbitrable issues. The district court denied Kawasaki's motion, holding that the arbitrator correctly interpreted the court's prior ruling and did not disregard any directives by the court; that the arbitrator arbitrated the issues submitted to him; and that the arbitrator therefore did not exceed his authority.

In the apparent belief that the district court was less knowledgeable than Kawasaki about the meaning and effect of the court's own prior rulings, Kawasaki appealed to the Eighth Circuit, which affirmed.

A. The dispute between the parties

This case has its genesis in Kawasaki's breach of the Dealer Sales and Service Agreements ("dealership agreements") between the parties. In February of 1993, Schultz filed a petition against Kawasaki in the Circuit Court of St. Louis County, Missouri, alleging breach of contract, tortious interference with a contractual relationship, breach of third-party beneficiary contract, and violation of the Missouri Motor Vehicle Franchise Practices Act, and seeking declaratory relief. Schultz's lawsuit arose from

Kawasaki's improper refusal, in 1992, to permit Schultz to purchase a third franchise or to relocate its franchises.

B. The arbitration provision

Paragraph 32 of the dealership agreements contained an arbitration provision. In Count V of its petition, Schultz's claim for declaratory relief, Schultz alleged that the arbitration provision was unenforceable in its entirety because it was embodied in a contract of adhesion and because it violated the public policy of Missouri as expressed in Missouri's Motor Vehicle Franchise Practices Act, Mo. Rev. Stat. § 407.820 (2000).

Kawasaki removed the case to the United States District Court for the Eastern District of Missouri based on the district court's diversity jurisdiction. Shortly thereafter, Kawasaki filed its Motion to Dismiss or for Other Relief. The "other relief" Kawasaki sought was that any issues that survived the dismissal motion be referred to arbitration in Los Angeles, California, pursuant to the arbitration provision in paragraph 32 of the dealership agreements.

The arbitration clause in the dealership agreement contained the following language:

> 32. DISPUTE RESOLUTION
>
> All controversies, claims and disputes arising in connection with this Agreement, except any controversies, claims and disputes relating to amounts due and unpaid to DISTRIBUTOR, relating to DISTRIBUTOR'S rights to retake possession of any Product or relating to third party personal injury, shall be settled by mutual consultation between

> the parties in good faith as promptly as possible, but failing an amicable settlement shall be settled finally by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and the parties hereto agree that such arbitration shall be the sole and exclusive method of resolving any and all such controversies, claims or disputes, except those expressly excluded above. Judgment upon such award may be entered in the Superior Court of the State of California for the County of Orange, if the award is rendered against DISTRIBUTOR, or in any court which has jurisdiction over DEALER, if the award is rendered against DEALER. The prevailing party shall be entitled to recover from the nonprevailing party all costs and expenses of the arbitration, including without limitation, attorneys' fees.

In its motion to dismiss, Kawasaki did not address the costs and fees provision in the last sentence of the arbitration clause.

C. The order compelling arbitration

The district court ruled on Kawasaki's motion on March 30, 1994. At the outset of the court's memorandum and order, the court recognized that, in deciding whether to submit a grievance to arbitration, it could not "rule on the potential merits of the underlying claims." The court stated that "the merits of the dispute and whether the failure to meet any prerequisites will bar recovery are for the arbitrator to decide."

The court *sua sponte* converted Kawasaki's motion to dismiss Schultz's claim for declaratory relief into a motion to compel arbitration. The court dismissed some of Schultz's claims and, after determining that the contract language reflected the parties' intent that "most disputes between the parties will be arbitrated, with certain exceptions not applicable here," the court referred all remaining claims to arbitration.

In its memorandum and order, the district court made several findings with respect to the parties' agreement to arbitrate. The court found that the agreement to arbitrate was not unenforceable as a provision in a contract of adhesion, citing Eighth Circuit case law stating that "the use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision." The court determined that there was nothing inherently unfair or unconscionable about the agreement to arbitrate. The court further found that there was sufficient mutuality of obligation with respect to the agreement to arbitrate, because the "parties agreed to arbitrate most claims either might have arising under the franchise agreements."

The district court also explicitly noted that discovery had not yet occurred in the case. In its memorandum and order, the court did not suggest that its ruling would preclude the arbitrator from determining the enforceability of any portion of the arbitration agreement after discovery had been conducted and evidence on that issue had been considered.

D. The court's additional instructions to the arbitrator

In accordance with the court's order, Schultz filed its demand for arbitration. On December 12, 1994, the American Arbitration Association appointed the Honorable Richard P. Byrne (a former California Superior Court judge) as arbitrator.

On February 3, 1995, Schultz filed an Amended Demand for Arbitration, in eight counts. Some of those counts restated claims – with additional factual assertions – that the district court had already dismissed or referred to arbitration, and some counts were new claims arising from a 1994 transaction between Kawasaki and Schultz. The arbitrator, reluctant to proceed with the arbitration without clarification from the district court as to what counts should be arbitrated, stayed the proceedings and referred the matter back to the district court to make whatever orders the court deemed appropriate to identify and clarify the issues to be considered in the arbitration proceedings.

The district court ruled on the arbitrator's request on August 7, 1995. The court held that the arbitrator should not hear Schultz's restated claims, for the same reasons those claims had been dismissed in the court's earlier memorandum and order. The court held that Schultz's new claims should be considered by the arbitrator.

E. The arbitration

The arbitration took place in Los Angeles, California, in March and April, 2000, and lasted three weeks. The issues of liability and damages were bifurcated. The arbitrator provided the parties with a Ruling on Liability

Issues on May 4, 2000. The arbitrator determined that Kawasaki was not liable to Schultz for damages. The arbitrator further stated that Kawasaki was the "prevailing party" and, in accordance with paragraph 32 of the dealership agreements, was entitled to recover the costs and expenses of the arbitration, including attorneys' fees. In making that statement, the arbitrator relied solely on the language of paragraph 32 of the dealership agreements; the arbitrator had not yet considered any defenses Schultz might raise to the enforceability of the fee provision. The arbitrator granted each party time to submit a memorandum on costs and expenses, and the right to request a hearing on these issues.

The hearing on costs and expenses was held in St. Louis, Missouri, on January 16 and 17, 2001. Kawasaki sought $1,760,438.63 in costs and expenses, including attorneys' fees.[1] Schultz opposed Kawasaki's request. At the hearing, both parties presented evidence and arguments.

After hearing "the allegations and proofs of the parties concerning [Kawasaki's] claim for costs and expenses," the arbitrator issued his Final Award of Arbitrator. The Final Award incorporated the arbitrator's prior Ruling on Liability Issues. In the Final Award, the arbitrator determined that the fee provision was unconscionable, and therefore unenforceable. The arbitrator's decision was

[1] At the hearing, Kawasaki reduced its requested amount of costs and expenses to $1,725,923.63. Several days after the hearing, Kawasaki increased the requested amount to $1,772,815.23, and submitted additional documentation purportedly supporting that request.

based on California law, in accordance with the choice-of-law provisions of the dealership agreements.

The arbitrator's decision was also based on the following evidence showing that Kawasaki pressured William Wefel, the president and sole shareholder of Schultz, into signing the dealership agreements containing the arbitration clause, and that Kawasaki wrote the agreements so as to make it extremely difficult and expensive for franchisees to pursue claims against Kawasaki.

The evidence showed that Mr. Wefel acquired a Kawasaki dealership from Bob Schultz in 1975, and a second dealership in 1981. For each dealership, Mr. Wefel signed standardized, identical agreements that did not contain arbitration clauses. The agreements were renewed annually. In 1987, Kawasaki presented Schultz and other franchisees with new three-year agreements, drafted by Kawasaki. The new agreements contained arbitration clauses. Mr. Wefel did not want the arbitration clause. The agreements were, however, non-negotiable. At the arbitration, Kawasaki did not dispute that, when it presented Schultz with the new contract, Kawasaki told Mr. Wefel that he had to sign the agreement or lose the dealerships. At the time Mr. Wefel was presented with this option, his investment in his dealerships comprised several hundred thousand dollars, and "more than a decade of time and effort in selling Kawasaki products" and developing his two locations into successful businesses. Mr. Wefel was presented with the same option of signing the agreements or losing his dealerships in 1990, when the renewed agreements – the agreements at issue here – were presented to him. Mr. Wefel felt he had no choice but to sign the agreements.

Testimony from Kawasaki's former Director of National Sales, Donald Pruitt, established that it was Kawasaki's official policy not to negotiate terms of its agreements with its dealers. Mr. Pruitt testified that he was not aware of any Kawasaki dealer other than Schultz that had brought a claim against Kawasaki. He testified that more than ninety-five percent of Kawasaki's dealers lacked the finances to proceed with a claim because of Kawasaki's ability to impose arbitration and make the procedure prohibitively expensive. In contrast, the evidence showed that Kawasaki could "well afford to pursue claims brought by franchisees with great vigor." In addition, the arbitrator found that the arbitration agreement lacked mutuality because Kawasaki, but not dealers, had the right to pursue certain claims in court.

The arbitration agreement required that arbitration take place in Los Angeles, "even though there [was] no reasonable justification or legitimate commercial purpose to be served by holding it there." The arbitrator found that "it appears that this requirement serves no purpose other than to make it more difficult and expensive for the franchisee to prosecute his claim." In this case, for example, counsel for both Schultz and Kawasaki were located in St. Louis, as were most of the witnesses. The arbitrator volunteered to hear the arbitration in St. Louis. Nevertheless, Kawasaki successfully resisted Schultz's efforts to have the arbitration conducted in St. Louis. Consequently, considerable costs and expenses were incurred that would have been unnecessary had the case been heard in St. Louis.

Finally, the Agreements permitted the prevailing party to recover *all*, not just reasonable, costs and expenses. The arbitrator noted that, under California law,

the prevailing party in a court proceeding would not be permitted to recover much of the cost and expense Kawasaki claimed in this arbitration.

Based on the evidence and the applicable law, the arbitrator ruled that each party would bear its own costs and expenses, and that Kawasaki and Schultz would equally bear the expenses of the American Arbitration Association and the arbitrator. The arbitrator made his ruling "in the exercise of his discretion under the applicable rules of the American Arbitration Association."

F. The confirmation of the award

Kawasaki subsequently filed in the district court a Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorneys' Fees, Costs and Litigation Expenses. Kawasaki argued that the arbitrator's decision denying Kawasaki its fees and expenses "must be vacated" on the theory that the district court had decided in its prior order that the fee provision was not unconscionable and was enforceable. Kawasaki argued that the court had not submitted the enforceability of the fee provision to arbitration. Kawasaki also argued that the arbitrator exceeded his authority by disregarding the district court's prior decision on the legal issues.

The district court denied Kawasaki's motion and entered its Judgment Confirming Arbitration Award on March 26, 2002. App. 177. The court concluded that "the arbitration award should be confirmed in its entirety," reasoning that the arbitrator had properly decided the issues submitted to him:

> [T]he arbitrator did not exceed his powers or award on a matter not submitted to him. The arbitrator correctly interpreted this Court's order of March 30, 1994, as addressing only the issue of arbitrability, *i.e.*, whether the arbitration provision between the parties should be enforced to require their dispute to be arbitrated. The Court did not address the attorney's fee provision, which was not mentioned in any of the parties' pleadings at the time.
>
> Given the arbitrator's power to interpret the Franchise Agreement, to find facts, to interpret and apply the law, and to make mistakes in so doing, the Court finds the arbitrator neither exceeded his powers nor awarded on a matter not submitted to him in determining that the attorney's fees portion of the arbitration provision was unconscionable under California law.

Kawasaki appealed the judgment confirming the award to the Eighth Circuit, which affirmed.

ARGUMENT

Because the district court could not, under the Federal Arbitration Act, partially vacate the Final Award of Arbitrator, the district court properly denied Kawasaki's Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorneys' Fees, Costs and Litigation Expenses. The Eighth Circuit properly affirmed the district court's judgment.

This case simply does not present the issues that Kawasaki suggests warrant certiorari. This is a case in which Kawasaki appealed from a judgment confirming an award. The cases in which Kawasaki purports to discern a conflict among the circuits are appeals from orders either granting or denying motions to compel arbitration. Kawasaki's cited cases relate to the standards employed when considering whether to compel arbitration, not whether to confirm the resulting award. Kawasaki never raised any issue about the order compelling arbitration in this case, and it never raised any objection about the proceedings or issues in the arbitration until after it was concluded. This case presents none of the issues that Kawasaki sets forth for this Court's review.

Kawasaki's arguments before this Court are remarkable – and flatly contradicted by the record and the governing law – given the history of this case. From the moment Kawasaki removed Schultz's case to federal court, Kawasaki insisted that all disputes arising out of the parties' dealership agreements, including the enforceability of the arbitration clause, be submitted to arbitration in California. Kawasaki participated in all phases of the

arbitration, including the arbitration hearing on Kawasaki's request for costs, expenses, and attorney fees.

Only after Kawasaki insisted on the arbitration and participated in it, and after the arbitrator found the fee provision unconscionable, did Kawasaki argue to the district court that the enforceability of the fee provision was never really submitted to arbitration. Then, Kawasaki argued to the district court for the first time that the court had already decided that the provision was enforceable in its prior orders submitting the dispute to arbitration. Kawasaki was wrong. The district court properly rejected Kawasaki's argument, holding that it had not previously decided that issue, that the issues arising out of the agreement had been submitted to arbitration, and that the arbitrator had acted within his jurisdiction in deciding the issues submitted to him.

Despite the district court's determination, in the Eighth Circuit, Kawasaki clung to its argument that the enforceability of the fee provision was never submitted to arbitration. The Eighth Circuit correctly rejected this claim. Kawasaki also asserted the new theory that the district court could have partially vacated and partially confirmed the arbitrator's final award because that single "Final Award" was actually two separate, distinct awards. This contention was properly rejected as well.

The undisputed facts show that the district court and the parties submitted the issue of the enforceability of the fee provision to arbitration. Kawasaki participated in the arbitration hearing on that issue. The arbitrator did not exceed his authority or award on an issue not submitted to him. Under the Federal Arbitration Act, Kawasaki could not obtain a judgment selectively confirming the favorable

portions of the arbitrator's award, and vacating the unfavorable portions. The district court properly denied Kawasaki's motion for such relief, and confirmed the arbitration award in its entirety. The petition for a writ of certiorari should be denied.

I. Kawasaki's asserted conflict among the circuits is not relevant to this case.

Kawasaki claims to be the victim of its own success. In the district court, Kawasaki vigorously insisted that all disputes between the parties must be submitted to arbitration. The district court agreed and referred the case to arbitration. Nothing prevented Kawasaki from refusing to submit the fee issue to the arbitrator. However, both parties submitted memoranda on the issue, and the arbitrator conducted a two-day hearing at which he received extensive evidence from both parties. Both parties fully participated in this hearing and submitted the issues to the arbitrator. Kawasaki should not now be heard to claim that the arbitrator improperly determined the fee issue.

Under these undisputed facts, the cases cited by Kawasaki are irrelevant to the issues in this case. The cases that are said to be in conflict ***all*** involve the issue of whether a district court properly submitted a matter to arbitration. *Investment Partners, L.P. v. Glamour Shots Licensing, Inc.*, 298 F.3d 314 (5th Cir. 2002) (appeal from order on motion to compel arbitration); *Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003) (same); *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (same); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002) (same); *Hadnot v. Bay, Ltd.*, 344

F.3d 474 (5th Cir. 2003) (same); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003) (same); *Shankle v. B-G Maint. Mgmt.*, 163 F.3d 1230 (10th Cir. 1999) (same); *Spinetti v. Service Corp. Int'l*, 324 F.3d 212 (3d Cir. 2003) (same); *Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001) (same); *Anders v. Hometown Mortgage Serv., Inc.*, 346 F.3d 1024 (11th Cir. 2003) (same); *Paladino v. Avnet Computer Tech., Inc.*, 134 F.3d 1054 (11th Cir. 1998) (same); *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801 (7th Cir. 2003) (same).

In this case, Kawasaki has no right to complain about the issues submitted to the arbitrator. Its motion to compel arbitration was ***sustained***. It never appealed from the order compelling arbitration. Kawasaki was always supremely happy to present all aspects of the parties' dispute to the arbitrator – until the award was rendered. Only then did Kawasaki begin to assert that the arbitrator acted beyond his authority. The district court and the Eighth Circuit properly rejected this about face.

Kawasaki did not raise the issue that is the subject of its petition in the arbitration proceedings. It did not raise this issue in the district court. It never directly raised this issue in the Eighth Circuit. If there is a conflict in the circuits on the issue suggested by Kawasaki, this case does not present it.

II. Kawasaki consented to the arbitrator's determination of the fee issue.

It is notable that Kawasaki asserts that this Court should use this case as a vehicle to "clarify the extent to which a district court's ruling on arbitrability . . . constrains the arbitrator's powers." Kawasaki failed to give

the district court a chance to do just this when the arbitration was proceeding. At one point, when the arbitrator required guidance from the court as to the issues he was to decide, Schultz filed a motion for the court to provide instructions to the arbitrator, which the court provided. (The court's order appears at page A-25 of Kawasaki's appendix.) Nothing prevented Kawasaki from asking the district court to clarify whether the fee issue was properly before the arbitrator, yet Kawasaki did not ask for this relief. Kawasaki never asserted that there was any need for such clarification. Kawasaki never sought declaratory or injunctive relief from the district court before commencement of the arbitration or the bifurcated damages portion of the proceedings. It is wholly inappropriate for Kawasaki to seek such relief from this Court in the first instance.

If through nothing else, certainly through its conduct Kawasaki granted the arbitrator jurisdiction to determine the merits of the fee issue. After initiating and participating in the arbitration, Kawasaki cannot now "be heard to argue the arbitrator had no authority to decide the issues submitted." *Franklin Elec. Co. v. Int'l Union, UAW*, 886 F.2d 188, 191 (8th Cir. 1989). A party's consent to arbitrate an issue may be implied from its conduct. *Id.* Consent to arbitrate is manifested by "arguing before the arbitrator not only the merits of a dispute, but also the question of arbitrability without expressly reserving the arbitrability determination for judicial review." *Id.* Kawasaki did just that. It did not reserve for the district court the question of whether the enforceability of the fee provision was arbitrable. There is nothing in the record indicating that Kawasaki preserved the question for judicial determination in its motion to compel arbitration or during the

arbitration proceedings. In fact, the district court expressly found that the fee provision was not mentioned in anything Kawasaki filed in the district court prior to filing its motion to vacate or modify the arbitration award.

III. The district court did not err in confirming the award.

Kawasaki, unhappy with the arbitrator's Final Award, asked the district court for dual relief that the Federal Arbitration Act does not authorize: confirmation of only that portion of the award favorable to Kawasaki, and vacatur of the unfavorable portion. Under the FAA, the district court could (1) confirm the award under Section 9; (2) vacate the award under Section 10; or (3) modify the award under Section 11. These were the only avenues of relief available to Kawasaki unless Kawasaki proved that the award was "completely irrational" or evidenced a "manifest disregard for the law." *Kiernan v. Piper Jaffray Companies, Inc.*, 137 F.2d 588, 594 (8th Cir. 1998). Absent one of the circumstances set forth in Section 11, the district court had no power to selectively modify the award by vacating only the portion unfavorable to Kawasaki. *UHC Management Co., Inc. v. Computer Sciences Corp.*, 148 F.3d 992, 999 (8th Cir. 1998) ("On a motion for confirmation, we have no power to selectively modify the award to delete such an order from the panel's decision unless one of the circumstances detailed in section 11 of the FAA applies"). The district court also had no power to vacate in part and confirm in part the arbitrator's award under Section 10. *Legion Ins. Co. v. VCW, Inc.*, 198 F.3d 718, 721 (8th Cir. 1999) ("the district court must take the award as it finds it and either vacate the entire award using section 10 or modify the award using section 11.")

Confronted with the settled law that bars it from cherry-picking the favorable portions of the arbitration award, Kawasaki attempted to argue on appeal that the arbitrator really issued *two* awards – a "First Award" and a "Second Award." Kawasaki sought to have the "First Award" confirmed and the "Second Award" vacated. In continuing to maintain this fiction, Kawasaki exhibits a remarkable talent for disregarding the record and its own arguments to the district court.

Before this appeal, Kawasaki harbored no illusions that the arbitrator issued two separate awards. Kawasaki filed in the district court a "Motion to Confirm the Arbitration Award as to Liability and to Vacate and/or Modify the Arbitration Award as it Pertains to Attorneys' Fees, Costs and Litigation Expenses." The very title of its motion reflected Kawasaki's request for modification or partial vacation of *the* single arbitration ***award***. The motion went on to request the court to "vacate and/or modify the ***portion of the arbitration award*** as it pertains to attorneys' fees, costs and litigation expenses." As Kawasaki conceded in the district court, the arbitrator issued only one award. The district court and the Eighth Circuit did not err in confirming this single award.

CONCLUSION

The petition for writ of certiorari should be denied.

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(3)

No. 03-704

IN THE

Supreme Court of the United States

KAWASAKI MOTORS CORP., U.S.A.,

Petitioner,

v.

BOB SCHULTZ MOTORS, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

By not addressing the merits of Kawasaki's petition, Schultz Motors implicitly concedes that the questions presented by Kawasaki are appropriate for this Court's consideration. Schultz Motors simply contends that this is not the right case for this Court to consider those questions. But its arguments in support of this contention are not well-founded.

A. This Case Presents The Same Issue As The Circuit Split.

Schultz Motors first tries to distinguish this case from the circuit split described in Kawasaki's petition. It contends that all of the cases involved in the circuit split concern pre-arbitration decisions by district courts. Since the District Court in this case allegedly erred in a post-arbitration decision, Schultz Motors contends that the issue here is different, making the case an inappropriate vehicle to resolve the split.

But the question presented here is whether the courts or an arbitrator should decide the enforceability of the terms of an arbitration argreement. The Eighth Circuit expressly decided this question with reference to Section 4 of the FAA using the same principles that it applies in pre-arbitration proceedings. App. A-7 – A-8.

The fact that the question arose after arbitration in this case is merely a function of Schultz Motors' delay in raising the issue. The applicable Eighth Circuit law would have been the same if Schultz Motors had raised the issue before arbitration.

B. Kawasaki Timely Objected to the Arbitrator's Action.

Schultz Motors next argues that certiorari is inappropriate because Kawasaki should have argued earlier

that the enforceability of arbitration terms is a question for the courts.

Schultz Motors' argument overlooks the fact that it gave no notice that it would be separately challenging the enforceability of the fee-shifting term until the hearing on the amount of fees. Before that, both parties had made all of their enforceability arguments to the District Court before the arbitration. When Schultz Motors first raised the enforceability issue with the Arbitrator, Kawasaki properly objected that enforceability had already been decided by the District Court. App. A-33.

Kawasaki thus made its objection as soon as Schultz Motors raised the enforceability of the fee-shifting term and the objection was timely.

C. Kawasaki Did Not Consent to Arbitrate the Fee-Shifting Provision's Enforceability.

Schultz Motors contends that Kawasaki consented to arbitrate the enforceability of the fee-shifting term by not "asking the district court to clarify whether the fee issue was properly before the arbitrator." Brief in Opp. 16.

Schultz Motors cites *Franklin Electric Co. v. International Union, UAW*, 886 F.2d 188, 191 (8th Cir. 1989). In *Franklin*, however, the resisting party argued the substance of the arbitrability question to the arbitrator. The court considered this substantive argument to be an implied consent to arbitrate that question. In this case, Kawasaki asserted that the issue of enforceability already had been decided and did not argue the merits of the issue to the Arbitrator. Thus, the dispositive fact in *Franklin* is not present here.

Moreover, the implied consent principle applied in *Franklin* has been superseded by this Court's ruling in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). Consent to arbitrate an arbitrability question now requires

clear and unmistakable evidence. *See id.* at 939 ("Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and umistakeabl[e]' evidence that they did so.") (quoting *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649 (1986)). Schultz Motors has made no argument that the *First Options* standard was met here.

D. The Relief Kawasaki Sought Is Permitted Under the FAA.

Schultz Motors suggests that an arbitration award cannot be vacated in part, and thus the Eighth Circuit was correct to affirm regardless of the resolution of the circuit split. This suggestion is incorrect. There is nothing in FAA Section 10 that requires the courts to vacate all of an award when there are independent portions of the award that should be confirmed.

In *Centralab, Inc. v. Local No. 816*, 827 F.2d 1210, 1217 (8th Cir. 1987), for example, the Eighth Circuit affirmed the district court's decision upholding an arbitrator's award on liability but vacating that award with respect to damages and remedies. *See also Lummus Global Amazonas, S.A. v. Aguaytia Energy Del Peru*, 256 F.Supp.2d 594, 600 (S.D. Tex. 2002); *Clarendon Nat'l Ins. Co. v. TIG Reinsurance Co.*, 990 F.Supp. 304, 311 (S.D.N.Y. 1998).

In an early decision by Chief Justice Marshall, this Court ruled that arbitration awards may be voided in part. *Lyle v. Rodgers*, 18 U.S. (5 Wheat.) 394, 409 (1820) ("That an award may be void in part, and good for the residue, will be readily admitted; but if that part which is void be so connected with the rest as to affect the justice of the case between the parties, the whole is void."); *accord Gasoline Products Co. v. Champlin Refining Co.*, 283 U.S. 494, 498-99 (1931) (discussing when it is appropriate to vacate a judgment in part). There is nothing in the FAA that changed this principle.

The cases that Schultz Motors cites do not support a contrary conclusion. *UHC Management Co., Inc. v. Computer Sciences Corp.*, 148 F.3d 992, 999 (8th Cir. 1998), involved a request to modify and then confirm an arbitration award. The court merely stated that it could not do so without proof that the requirements of FAA Section 11 were met. This unremarkable holding might be stretched to weakly imply that Section 10 cannot be used to partially vacate an arbitration award. But that certainly is not the holding of the case.

Schultz Motors also quotes *Legion Ins. Co. v. VCW, Inc.*, 198 F.3d 718, 721 (8th Cir. 1999). But in that case the Eighth Circuit did not reach the issue of whether a court could vacate in part: "[W]e make no finding at this time as to whether the district court was correct [in vacating in part and remanding in part]. Under the conditions of this appeal, we need not reach the question...." *Id.* Instead, the court found that the arbitrator had expressly intended that the arbitration award be indivisible and found that, on those specific facts, the court could not vacate in part. *Id.* In contrast, in the present case, the Arbitrator never stated that he intended his two separate awards to be indivisible but instead bifurcated the proceedings and issued two separate, distinct awards.

Schultz Motors' position is further undercut by the fact that every federal court to consider the question of whether the liability phase of a bifurcated arbitration proceeding can be challenged by vacation or modification has held in the affirmative. *See Hart Surgical, Inc. v. UltraCision, Inc.*, 244 F.3d 231, 235 (1st Cir. 2001) (where the liability and damages portion of an arbitration are bifurcated, holding "the liability determination is final and subject to district court review"); *Trade & Transport, Inc. v. Natural Petroleum Charterers, Inc.*, 931 F.2d 191, 195 (2d Cir. 1991) (stating that arbitrator's determination of bifurcated liability issue is final award, and its authority over that issue is ended);

McGregor Van De Moere, Inc. v. Paychex, Inc., 927 F.Supp. 616, 618 (W.D.N.Y. 1996) (finding, where arbitrator decides every liability issue in a bifurcated proceeding, the order is final for the purposes of review under the FAA). If a court can review only one of two bifurcated awards then a court must be able to vacate only one of two bifurcated awards.

Moreover, the courts' authority to vacate arbitration awards is phrased in substantially the same terms as their authority to vacate judgments. *Compare* 28 U.S.C. §2106 *with* 9 U.S.C. § 10. The courts certainly vacate judgments in part. *See, e.g., City of Cuyahoga Falls v. Buckeye Community Hope Foundation*, 538 U.S. 188 (2003). They should have a similar authority to vacate arbitration awards in part, assuming that the standards of Section 10 are satisfied.

Finally, regardless of whether an arbitration award may be vacated in part under Section 10, it certainly may be modified in part under Section 11. Since Kawasaki also challenged the Arbitrator's decision under Section 11, there is no basis for denying certiorari upon the premise that the FAA does not authorize the relief that Kawasaki seeks.

E. Conclusion

For the reasons given in the petition and this reply, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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